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NEWS

Stati v Kazakhstan: the winner takes it all?

Astana, Kazakhstan (Credit: iStockphoto/Vasca)

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High-profile attachments obtained by Moldovan creditors against billions of dollars in Kazakh state assets highlight the importance of choosing the right enforcement strategy, say partner **Deborah Ruff** and counsel **Julia Kalinina Belcher** of Pillsbury Winthrop Shaw Pittman in London.

The progress of enforcement proceedings by Moldovan investors Anatolie and Garbiel Stati and their companies against Kazakhstan arising out of their 2013 Swedish Chamber of Commerce award is well publicised. But what has hitherto been less remarked upon is how these proceedings have given rise to issues concerning the interaction between the enforcement "tools" available to award creditors in different jurisdictions.

Background

In December 2013, the Stati parties obtained an SCC award of just over US$500 million against Kazakhstan. The tribunal found that Kazakhstan was liable for breaching the Energy Charter Treaty, primarily its fair and equitable treatment provisions.

Kazakhstan sought to annul the award in Sweden, the seat of the ECT arbitration, partly on the basis that the Stati parties obtained it by fraud. Their challenge was ultimately unsuccessful: the Svea Court of Appeal and the Supreme Court effectively upheld the award without examining the substance of the state's fraud claims.

Meanwhile, the Stati parties took the award to various jurisdictions for enforcement. One of their targets was the Bank of New York Mellon (BONYM), which is incorporated in Belgium but ultimately owned by the US-based The Bank of New York Mellon Corporation. BONYM has branches in Frankfurt, Amsterdam, Paris, Dublin, Luxembourg, Milan and London. It provides banking and custody services to the National Bank of Kazakhstan, which manages assets on trust for the state, in respect of the National Fund of Kazakhstan, a sovereign wealth fund.

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In 2014, the Stati parties applied to the Dutch courts for garnishment orders on 40 companies and 17 banks, including BONYM, and were awarded provisional leave to do so. However, the Dutch Ministry of Justice was reported to have blocked the attachments shortly after on the basis that the assets were not shown to have been held for commercial purposes, presumably on the basis of the sovereign immunity doctrine.

In August 2017, the Stati parties made a new ex parte application in the Dutch courts, seeking pre-enforcement attachments of BONYM's assets in and outside the Netherlands. Although the decision granting attachments stated that they were not to apply to BONYM's branches outside the Netherlands, the garnishment orders issued pursuant to the attachment decision were not limited in that way and, on their face, extended to BONYM's assets both in and outside the Netherlands. As a matter of Dutch law, garnishment is not limited to the amount of debt owed by the debtor to the creditor, but is unlimited in amount.

Having taken legal advice, BONYM took the view that the Dutch garnishments were apt to apply to all of the National Fund's assets held by BONYM's London branch under the 2001 global custody agreement between BONYM and the National Bank. BONYM froze US$22.6 billion in cash, bonds and equity shareholdings.

The Stati parties also successfully attached a further US$5.2 billion in other assets held by Kazakhstan sovereign wealth fund Samruk-Kazyna in the Netherlands, targeting its indirect interest in the consortium that runs an oil field in the Caspian sea.

The US$22.6 billion attachment on BONYM's accounts was lifted in January 2018 by the Dutch courts, which held that the assets held by BONYM could not offer recourse for creditors of Kazakhstan, notwithstanding that the state might be the ultimate beneficiary. The Dutch courts found that the US$22.6 billion worth of assets frozen were effectively the same assets that were the subject of the Stati parties' failed 2014 application. The reasoning appears to have been the sovereign immunity doctrine and the non-disclosure of the earlier application. Nevertheless, the Amsterdam court refused the request from the National Bank for a permanent ban preventing new attachments of BONYM's assets.

In October 2017, the Belgian courts granted the Stati parties' application for attachments and garnishments for largely the same assets as those frozen by the Dutch courts. BONYM, upon legal advice, took the view that the garnishment properly extended to all of the assets held by it under the GCA, since under Belgian law a garnishment at a bank's place of incorporation covers all assets, whether or not they relate to activities of a branch of that bank outside Belgium. However, in May 2018, Belgian courts lifted the freeze on over US$22 billion in assets held by BONYM, limiting the size of the attachment to US$530 million.

The Stati parties also obtained an attachment order worth around US$100 million in respect of Kazakhstan's shareholding in 33 Swedish public companies from the Swedish courts. Since the affirmation of this attachment in January 2018, Swedish state bailiffs have commenced the foreclosure process.

In Luxembourg, the Stati parties secured a further garnishment order against BONYM and attachments of Kazakhstan's shareholding in Luxembourg-based Eurasian Resources Group, as well as of trade receivables due to Kazakhstan from a number of Luxembourg companies.

In September 2014, the Stati parties started proceedings in the US courts to enforce the award, where the courts twice refused to allow Kazakhstan to introduce allegations of fraud as a defence against enforcement. It is reported that Kazakhstan intends to appeal the latest decision.

In early 2014, the English High Court initially granted the Stati parties permission to enforce the award in England. Kazakhstan applied to set it aside on the grounds that there was no valid arbitration agreement; the tribunal was not validly constituted; and there had been serious procedural irregularities preventing Kazakhstan from putting its case to the tribunal. Having later obtained disclosure of documents from US courts that Kazakhstan says show that the award was obtained by fraud, the state sought to amend its initial set-aside application to add a further ground: that enforcement of the award would contravene English public policy by reason of fraud by the Stati parties.

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Importance of enforcement strategy

The worldwide enforcement strategy adopted by the Stati parties has highlighted the importance of making the right choice of the jurisdiction in which enforcement orders are to be sought so that it can be used as a "springboard" for reaching assets globally.

For example, the attachment/garnishment orders obtained from the Dutch and Belgian courts resulting in a freeze of US$22.6 billion worth of assets – many times more than required to satisfy the award debt – have made it unnecessary for the Stati parties to pursue enforcement proceedings in other jurisdictions.

Until recently, there still remained the question of fraud, which Kazakhstan says was committed by the Stati parties and which is said to have influenced the arbitrators' award. In June 2017, the English High Court, highlighting differences in the scope of the "public policy" exception under the New York Convention in various jurisdictions, ruled that, in light of the new evidence that the state obtained in US proceedings, there was a "sufficient prima facie case" that the award was obtained by fraud. The English court rejected the Stati parties' argument that Kazakhstan was issue estopped from advancing fraud allegations, considering that neither the Swedish, US nor English courts have decided the merits of that question. Moreover, Knowles J held that, even if the issue estoppel had been made out, the English courts would still have to decide if the enforcement of the award should be permitted applying English public order considerations. The new evidence is said to show that the tribunal's assessment of the damages due to the Stati parties was based on an indicative bid for the LPG plant, which was allegedly based on untrue information provided by the Stati parties.

The trial on the merits of the state's allegations was scheduled for November 2018, however the Stati parties have sought to discontinue their enforcement application in England, rendering the hearing unnecessary. A possible strategic basis for this decision may have been to avoid a possible situation where at least one jurisdiction had held the award to be unenforceable, for fear that this could prejudice enforcement efforts elsewhere.

In May 2018, the English High Court made an "exceptional conclusion" that the Stati parties' notice of discontinuance be set aside and the state's fraud allegations proceed to trial, because Kazakhstan has a legitimate interest in setting aside the permission to enforce the award in England. Knowles J stated that, "in the context of a global multi-jurisdictional enforcement exercise by the Statis I respectfully take the view that it will not be without use to the Courts of at least some other countries to have a concluded answer on the question of fraud [...], and therefore on the question of whether the English Court would enforce the Award".

The English court's readiness to read the decisions of foreign courts on the issue of fraud narrowly and to consider whether there was the fraud described affecting a foreign award which has been upheld by the courts at the seat of the arbitration is, perhaps, surprising. Although the New York Convention allows the country of enforcement to take into account its own public policy in deciding whether to allow enforcement of an award, the English courts have, arguably, assumed the role of the court of the seat.

The May 2018 decision to set aside the Stati parties' notice of discontinuance goes further still. Notwithstanding the filing of the notice to discontinue by the Stati parties, the English court concluded the question of whether the award could be converted into a judgment of the English Court should, nonetheless, be answered.

This development may lead to paradoxical results. Kazakhstan's efforts to halt the enforcement of the award in Sweden on the basis of the alleged fraud was unsuccessful. The Svea Court of Appeal held that, given the narrow scope of the application of the public policy provision as a matter of Swedish law, there could be "no question of declaring an arbitral award invalid solely on the ground that false evidence or untrue testimony has occurred, when it is not clear that such have been directly decisive for the outcome" or that there was an "indirect impact on the arbitral tribunal in its assessment of the dispute", unless it is obvious that such indirect influence "has been of decisive significance for the outcome of the case". The Swedish court concluded that this was not the case, but did not examine the question of whether the false information provided by the Stati parties had an indirect decisive impact on the tribunal's assessment of the Stati parties' damages.

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The US courts also refused Kazakhstan's motion to amend its application to add the alleged fraud to the grounds for opposing enforcement.

At the moment, therefore, no court has yet fully tried or decided the question of whether the alleged fraud took place. In the meantime, the Dutch attachments against US$5.2 billion in assets held by Samruk and US$530 million in BONYM assets are still in place – at least, at the moment – as are the Swedish and Luxembourg attachments on other assets.

This highlights how an award creditor, having selected lucrative "targets" for enforcement, can use the jurisdictions that have the narrowest application of public policy considerations, and the widest interpretation of what amounts can be frozen as "springboards" for reaching assets in other jurisdictions, even if the award is ultimately denied enforcement in those latter jurisdictions.

Further, the proceedings have also highlighted the invidious position in which third parties, such as banks holding the award debtor's assets, may find themselves. The value of assets of the NBK frozen by BONYM pursuant to the Belgian and Dutch orders was 45 times the amount awarded to the Stati parties and comprised around 40% of the value of the entire sovereign fund. By complying with the orders, BONYM no doubt sought to negate the risk of civil liability for the amount of the Stati parties' claims, as well as potential criminal liability in Belgium and the Netherlands, had it defied the orders. However, BONYM's compliance with the orders led its customer the National Bank (and Kazakhstan) to bring claims against it in the English High Court under the global custody agreement, seeking a number of declarations designed to establish that BONYM was not obliged or entitled to freeze the Kazakh assets.

The enforcement campaign pursued by the Stati parties highlights the need for the award creditor to have a strategy that would yield the best results with minimal efforts. However, as we have seen, executing the strategy may sometimes lead to unpredictable results.

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