Yukos and Contributory Fault
by W. Sadowski

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Wojciech Sadowski¹ - *Yukos and contributory fault*

1. Overview

The concept of contributory fault in international law has been developed to address the consequences of blameable conduct of a party injured by an internationally wrongful act.² It has been applied most recently in the three awards rendered in the arbitration between the majority shareholders of Yukos and the Russian Federation (referred to hereinafter as *Hulley* awards).³ In these awards, the tribunal reduced the damages awarded to the claimants by 25 %, which was the figure corresponding to the tribunal’s assessment of the claimants’ contribution to the injury. In nominal terms, this led to the reduction of damages by USD 16.7 billion, from USD 66.7 billion to USD 50 billion. The present paper provides an analysis of that particular aspect of the *Hulley* awards.

There are three essential requirements for contributory fault to come into play, namely: (1) existence of an internationally wrongful act of the state, (2) blameable conduct of the injured party and (3) the causal link between that blameable conduct and the injury suffered by that party. Clear logic underpins these requirements. With regard to the first requirement, if there is no internationally wrongful act, the state cannot be held responsible for it, and accordingly, there can be no issue of contributory fault. This is true, in particular, for situations in which the conduct of the state is a justified response to the conduct of the injured party. For example, material incompliance by an investor with the conditions of a license, state aid, tax exemption or other public law entitlement, may authorize the state to revoke it. This in turn may imply the investor’s obligation to return the corresponding benefits, and put in question the financial viability of the investment. If the entitlement is revoked by the state in accordance with the legal regime applicable to it, and in good faith, no issue

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³ *Veteran Petroleum Limited (Cyprus) v. The Russian Federation*, UNCITRAL, PCA Case No. AA 228, Final Award of 18 July 2014 (“*Veteran*”); *Hulley Enterprises Limited (Cyprus) v. The Russian Federation*, UNCITRAL, PCA Case No. AA 226, Final Award of 18 July 2014 (“*Hulley*”) and *Yukos Universal Limited (Isle of Man) v. The Russian Federation*, UNCITRAL, PCA Case No. AA 227 Final Award of 18 July 2014 (“*Yukos*”). The proceedings in the *Veteran*, *Hulley* and *Yukos* cases were joined and handled by the same tribunal, which issued three virtually identical awards in all three cases on the same day. To avoid possible confusion, these awards are referred to jointly in this paper as the *Hulley* awards.
of international responsibility would arise under those circumstances, regardless of the possible loss of
the investor. Whereas, unjustified revocation of the entitlement may give rise to international
responsibility of the state. Article 39 of the ILA Articles on Responsibility of States for
Internationally Wrongful Acts (the “ARSIWA”), in Part Two “Content of the International
Responsibility of a State”, implicitly confirms that the concept of contributory fault becomes relevant
only when there is an internationally wrongful act of a state, which triggers its international
responsibility.

Second, the conduct of the injured party must be blameable, e.g. it must be inconsistent with
the pattern expected from the party in the specific circumstances. This qualification of the conduct of
the injured party as blameable is necessary, since otherwise there would be no justification to limit the
obligation of the responsible state to fully undo the consequences of its breach of international
obligations (including to “make full reparation for the injury caused by the internationally wrongful
act”). However, international law is remarkably unclear on which type of conduct should be regarded
as blameable. Traditionally, the notion of blameable conduct was interpreted rather loosely to include
“a variety of situations, ranging from negligence, deceit or immoral behaviour to the most severe
violations of the domestic law or human rights”. Article 39 ARSIWA refers to conduct which is
“wilful or negligent”. This terminology, however, is also ambiguous. The doubts as to its meaning are
not removed by the reference in the commentary to the ARSIWA that “this terminology is drawn from
the Convention on the International Liability for Damage caused by the Space Objects”. Moreover,
although in most cases the blameable conduct of the victim arises from a breach of law, either
domestic or international, this is not a necessary requirement. In particular, the MTD v. Chile award

4 In this respect, contrast e.g. Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States, ICSID
Case No. ARB (AF)00/2, Award of 29 May 2003 and Robert Azinian, Kenneth Davitian, & Ellen Baca v. The
United Mexican States, ICSID Case No. ARB (AF)/97/2, Award of 1 November 1999.
5 International Law Commission Articles on Responsibility of States for Internationally Wrongful Acts, Annex
to the Resolution of the United Nation Assembly No. 56/83 of December 12, 2001 and corrected by document
6 B. Bollecker-Stern, Le préjudice... p. 303.
7 Article 31(1) ARSIWA.
8 M. Salmon “Des manes propres comme condition de recevabilité des réclamations internationales”, AFDI
9 J. Crawford, The international Law Commission’s Articles on State Responsibility, Introduction, Text and
establishes that lawful but commercially imprudent behaviour may also be regarded as blameable.\textsuperscript{10} Provocative conduct may also be considered as blameable. It was so regarded under customary international law (outside the scope of investment treaty protection),\textsuperscript{11} and may equally trigger the exclusion of the investor’s political risk insurance coverage.\textsuperscript{12}

Third, the requirement of the causal link between the blameable conduct and the injury is necessary. It has been pointed out by B. Stern that there are three possible theoretical approaches, which one could take with respect to the consequences of the blameable conduct of the injured party with respect to reparations (damages): (1) to deny the right to recover damages in view of the blameable conduct, (2) to look at the gravity of the conduct of the injured party as the criterion for determining what the consequences of that conduct should be, or (3) to accept that the blameable conduct of the injured party does not always need to lead to the reduction of damages, and that such reduction is only appropriate where there exists a causal link between the conduct and the extent of the

\textsuperscript{10} In \textit{MTD v. Chile} the tribunal found that the investor acted imprudently, without proper legal due diligence and paid the price of the real estate upfront, whereas, according to the tribunal, it would have been more prudent for the investor to insist on different payment terms \textit{(MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile, ICSID Case No. ARB/01/7, Award of 25 May 2004, paras. 242-243, “MTD”). See also S. Ripinsky, K. Williams, \textit{Damages...}, p. 315-318, who further point to \textit{Azurix Corp. v. The Argentine Republic}, \textit{(ICSID Case No. ARB/01/12, Award of 14 July 2006)} as another example of damages reduced due to the investor’s imprudent conduct. They also refer to the \textit{Case concerning S.S. Wimbledon}, \textit{(PCIJ, Judgment of 17 August 1923, Series A, p. 31)}, \textit{Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic} \textit{(ICSID Case No. ARB/01/3, Award of 22 May 2007)} and \textit{CME Czech Republic B.V. v. The Czech Republic} \textit{(UNCITRAL, Partial award of 13 September 2001)} as other examples of cases where diligence and reasonableness of the conduct of the injured party was analysed by international courts and tribunals.

\textsuperscript{11} See e.g. \textit{Lillie S. Kling (U.S.A.) v. The United Mexican States}, where reckless gun-firing in the air was held to provoke the internationally unlawful killing of a U.S. national by Mexican soldiers \textit{(R.I.A.A., Vol. IV, at p. 575, at p. 585). The \textit{Hulley} awards referred to this type of provocative conduct in para. 1605.}

\textsuperscript{12} M. Kantor, \textit{Are You in Good Hands with Your Insurance Company? Regulatory Expropriation and Political Risk Insurance Policies}, in T.H. Moran, G.T. West and K. Martin (eds.), \textit{International Political Risk Management: Needs of the Present, Challenges for the Future}, World Bank Group 2007, p. 138 at p. 160 et seq. It should be noted, however, that the ‘provocative act’ exclusion in the political risk insurance conditions may embrace a broader category of situations, in which the loss was caused by unreasonable, imprudent or illegal (in particular corruptive) conduct of the investor or its local enterprise. Some of the instances in which the exclusion was applied, seem to refer to the conduct of the investor after, and not before, the impugned measure of the state (e.g. with respect to unreasonable failure to pay tax assessments, see OPIC Memorandum of Determinations, Confiscation Claim of Marine Shipping Corporation, Contract of Insurance No. CO15, p. 2-3). In summary, the notion of provocative act in political risk insurance policy conditions is a contractually defined concept, going beyond the notion of contributory fault, or the type of provocation referred to in the preceding footnote.
injury suffered by that party in relation to the internationally wrongful act. It was also convincingly argued that the first two approaches are untenable - the first approach is illogical and based on internal contradictions, while the second would imply that the international law of state responsibility acquires a penal character, which is generally denied. Accordingly, the only remaining possibility is to examine the factual implications of the conduct of the injured party for the extent of the injury, with a view to determining causality.

The requirement of causality is also reflected in the ARSIWA. Several provisions make clear that the injury is required to be caused by an internationally wrongful act of the State; thus it cannot be caused by the blameable conduct of the injured party. Article 31(2) ARSIWA states that “the responsible State is under an obligation to make full reparation for the injury caused by the internationally wrongful act”. Causality is also expressly referred to in Article 34 (“full reparation for the injury caused by the internationally wrongful act” and Article 36(1) (“The State responsible for an internationally wrongful act is under an obligation to compensate for the damage caused thereby”), as well as in Article 37 (referring to the “injury caused by that [internationally wrongful] act”). However, the requirement in Article 39 that the wilful or negligent conduct contributes to the injury clearly indicates that a cause-effect type link is required between the conduct in question and the extent of the injury.

One important conclusion which stems from the foregoing examination of the three requirements of contributory fault is that blameable conduct of the injured party may lead to different consequences. First, the blameable conduct may justify the acts of the state, hence precluding any international responsibility for those acts. Second, the blameable conduct may remain without any consequences, if it does not justify the internationally wrongful acts of the state, but also does not contribute to the injury. Third, if the blameable conduct of the injured party does not preclude international responsibility of the state, but it does impact the extent of the injury suffered, it will be relevant for the determination of damages. The concept of contributory fault corresponds to this third scenario.

The present paper analyses the Hulley awards in light of these criteria. In its first part, the paper submits that the Hulley decision has two important weaknesses. The first one relates to the requirement of contribution, which requires a cause-effect link between the blameable conduct of the injured party and the injury. This paper seeks to show that the tribunal’s identification of the blameable conduct of Yukos in the use of a potentially abusive tax structure by that company is


inconsistent with the determinations made by the same tribunal that Russia had acted in an orchestrated manner to expropriate Yukos, and that the invocation of the tax laws was merely a pretext to achieve that goal. The pretextual nature of the tax proceedings, this paper submits, removes the relevance of the tax structure to the treatment Yukos received from the Russian Federation. The second perceived weakness of the Hulley tribunal’s reasoning is how it measured the scope of the putative contribution of the abusive tax scheme to the extent of injury suffered by the claimants. The paper seeks to show that, based admittedly solely on the materially incomplete data provided in the Hulley awards, it is possible to induce that the financial implications of the tax scheme used by Yukos - assuming that the scheme had actually been contrary to Russian law and that Russia had applied legitimate sanctions against Yukos or that the case settled on terms similar to those afforded to other companies in similar circumstances - would have been much smaller than the USD 16.7 billion assessed by the tribunal.

In the second part, the paper will attempt to show that other instances of potentially blameable conduct of Yukos, analysed by the Hulley tribunal (i.e. the conduct related to the auction of YNG and to the repayment of a loan owed to foreign banks), could likewise have no relevance for the concept of contributory fault due to the lack of causal link between the conduct of Yukos and the injury. The paper further looks at whether any other conduct of Yukos and its principals influenced on the creation or extent of the injury. The three areas identified in the paper include (1) the acts of Mr. Khodorkovsky in 2002 and early 2003, (2) the approach taken by Yukos to the dispute resolution strategy once the tax reassessments started, and (3) certain actions during the course of the enforcement proceedings that had the effect of removing those assets from the reach of the Russian Federation. The paper submits, however, that none of these would qualify as “contributory”, either because the conduct in question cannot be regarded as blameable, or because the manifest lack of proportionality in Russia’s conduct, as determined by the tribunal, would break the link between the potentially blameable conduct of Yukos and the injury. As shown in Section 2.2.1 of this Article, where the state’s conduct becomes internationally unlawful because it clearly fails to provide a proportionate response to the blameable conduct of the investor, that lack of proportionality becomes the only source of injury and the blameable conduct of the investor loses its relevance.

Accordingly, the paper submits that the concept of contributory fault should not have been applied in Hulley. At the same time, it is argued in the third part of the paper that the consequences of the conduct of Yukos related to: (1) the potentially abusive tax structure, and (2) the reported operations stripping Yukos of assets in the course of the enforcement proceedings, should have been taken into account by the tribunal at the time of the determination of the amount of damages due to the claimants. The paper submits specifically that in the process of determination of the fair market value of Yukos in a no-breach scenario (i.e. the hypothetical scenario in which Russia had acted in accordance with the international law), the Hulley tribunal should have included the hypothetical
implications of legitimate sanctions that Russia could have applied against Yukos to levy taxes in accordance with both domestic and international law on account of the allegedly abusive tax structure. Likewise, the fair market value of the assets removed by the shareholders of Yukos from the reach of the enforcement measures should have been deducted from the amount of damages due to them to the extent the claimants were able to preserve their control over these assets. This reduction would clearly be required in order to avoid overcompensation of the claimants.

Finally, part four focuses on three aspects of contributory fault that may have special importance in the field of investment treaty law: (1) attribution of the blameable conduct of third parties, e.g. local managers, to the investor, (2) the implications of contributory fault in those cases of indirect expropriation, where the loss of value of the investment results from the combination of the internationally wrongful conduct of the state and the blameable (e.g. negligent) conduct of the investor, and (3) deficiencies of the approach reflecting the consequences of contributory fault as a percentage of the damage. The overall conclusion is that the concept of contributory fault should be applied with caution, and possibly as a tool of last resort.

1. Contributory Fault Doctrine Applied by the Hulley Tribunal

1.1. Overview of the Dispute

The Yukos cases featured an apparent conflict of legitimate interests and values: the right of the investor to be protected against a wilful and arbitrary confiscation of its investment by the host state acting for political reasons, and the right of the state to enforce its tax laws and combat tax abuse. In a perfect world that conflict does not exist. It is undisputed that states have the right to impose and collect taxes. As the RosInvestCo Tribunal observed, they enjoy “wide latitude” in that respect, even if it results in substantial deprivation of investors’ assets.16 It is also axiomatic that general taxation imposed and enforced by states in good faith and in a non-discriminatory manner, although constituting compulsory deprivation of property, is not compensable under international law.17 The

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right of states to impose and collect taxes creates a corollary duty of the taxpayers, including the investors, to pay them. This duty forms part of a wider obligation of investors to comply with the domestic law of the host state and not to abuse it. This non-controversial principle of international investment law was invoked by Russia as the primary defence in all the Yukos treaty arbitrations. Russia argued in particular that the tax structure of the Yukos group, used for the sale and export of oil products, amounted to a bad-faith abuse of the Russian tax law, which it was legitimate for Russia to counter and prosecute.

None of the three arbitral tribunals seized with the Yukos treaty claims was persuaded by that defence in light of the overall conduct of the Russian authorities. Without replicating the extensive facts of the case presumed to be generally known, it can be fairly summarized that said conduct manifested itself in at least five different spheres: (1) measures related to the imposition and enforcement of taxes, (2) criminal proceedings directed against the owners, officers, advisors and supporters of Yukos, (3) institution and conduct of bankruptcy proceedings, involving in particular a secret agreement with a consortium of foreign banks, (4) a campaign of intimidation and harassment aimed at third parties such as the legal advisers or auditors of Yukos, in order to dissuade them from lending support to the company, and (5) measures iure dominii, including the use of Rosneft and other state-controlled entities in the process of dismantling Yukos, thus creating an appearance of “absolutely legal market mechanisms”. Arguably, it is not possible to stretch the blanket of good-faith tax measures to cover the entire spectrum of these incidents, many of which were unrelated to taxation.

However, while the use of the potentially tax abusive structure did not deprive Russia’s conduct of its internationally unlawful nature, it remained troubling. Apart from the tax structure used by Yukos, there were also other serious infractions or offences that Russia alleged were committed by Yukos, its officers or owners. Those allegations were heard and considered by the arbitrators.

18 I.e. RosInvestCo, Quasar and Hulley.

19 One could draw a certain analogy, for example, between the Yukos case and Barcelona Traction. In both cases states purported to justify their actions with allegations of faulty conduct on the part of the company. Although no decision on the merits was rendered in Barcelona Traction, the following passage from the World Court’s judgment remains very pertinent to the subject of the present paper: “It has been argued on one side that unlawful acts had been committed by the Spanish judicial and administrative authorities, and that as a result of those acts Spain has incurred international responsibility. On the other side it has been argued that the activities of Barcelona Traction and its subsidiaries were conducted in violation of Spanish law and caused damage to the Spanish economy. If both contentions were substantiated, the truth of the latter would in no way provide justification in respect of the former”, the case of Barcelona Traction, Light ad Power Company limited (Belgium v. Spain), Judgment of 5 February 1970 (Second Phase), ICJ Rep. 1970, p. 52.

20 Hulley, para. 1472.
Therefore, while Russia’s conduct was found inexcusable by the RosInvestCo, Quasar and Hulley tribunals, they also sought to strike a reasonable balance between conflicting values. Each of the three tribunals, however, reacted differently to those concerns. The RosInvestCo tribunal accepted that while “contributions of Yukos to its own demise do not change the conclusion that Respondent breached the IPPA with regard to Claimant's shares, they may be relevant in the consideration later in this Award of the quantum of any damage due to Claimant”. However, the RosInvestCo tribunal did not explain any further what the relevance of the contributions for the quantum might have been, as it chose to rely on the sunk-cost approach to damages and ultimately compensated the claimant with the amount representing the price it had actually paid for the Yukos shares, plus interest. The Quasar tribunal was the least sympathetic to Russia’s tax defence and the legal theories that purported to underpin it. It was also most tolerant towards Yukos, rejecting the contention that transactions with companies established in low-tax jurisdictions were sham. It went on to conclude that the tax structure was not abusive, but might have led to transfer-pricing issues. To the Quasar tribunal: “Since the loss of tax revenues was evidently attributable to non-arms'-length inter-group pricing, the natural correction would be to disqualify those prices and to reintegrate into the producing entity's tax base an amount which would restore arm's length.” With respect to the company’s conduct in the course of the enforcement proceedings, the Quasar tribunal succinctly observed that: “If Yukos' owners and management concluded that the Russian Government had set its face against them and was pursuing an objective of confiscation, they would hardly have been encouraged to keep profits sitting nicely where they could be taken by state power. If the storm clouds were so ominous, there was no reason to invest in assets within the jurisdiction (because they would be susceptible to dispossession by force) and the perfectly understandable reaction would be to save what could be saved of what is, after all, presumptively the property of any corporate entity's owners.” Accordingly, the conduct of Yukos had no influence on the level of damages awarded to the claimants in the Quasar case. Mindful of the fact that it was dealing with claims of minority shareholders who had no real influence on the conduct of company, the Quasar tribunal anchored the market value of the claimants’ investment (shares) to the market price at which the Yukos shares were publicly traded at the date chosen for valuation. Whereas the choice of the specific date implicated certain “downward adjustment” with respect to

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21 RosInvestCo, para. 634.  
22 RosInvestCo, para. 675.  
23 Quasar, para. 65.  
24 Quasar, para. 123.  
25 Quasar, paras. 205-206.  
26 Quasar, paras. 215-216.
the price at which the investment had been made, nothing in the award suggests that the adjustment was applied in consideration of the possible contributory conduct of Yukos.

The Hulley tribunal took a different approach. Notably, while it held Russia to be responsible for the unlawful expropriation of Yukos, it also determined that the claimants significantly and materially contributed to that injury because of the potentially abusive and “sham-like” tax structure operated by Yukos. As a consequence, it found that the claimants contributed to their injury in 25%. Accordingly, the damages awarded to the claimants were reduced by the corresponding fraction, which totalled USD 16.7 billion. Before proceeding with an analysis of this decision, it is pertinent to recall the key findings of the Hulley awards.27

1.2. Key Findings of the Hulley Awards

The central theory underlying the Hulley awards was that the actions taken by the Russian state against Yukos were not an accidental ensemble of bona fide taxation measures. Rather, they were considered by the tribunal to be a part of a single operation, carried out by various organs and instrumentalities of the Russian Federation with the preconceived aim of destroying Yukos, appropriating its assets and imprisoning its key owners and officers.28 The Hulley tribunal’s conviction that Russia acted with a predetermined aim to destroy Yukos and that its measures were not taken in good faith, permeate various parts of the awards. The tribunal found in particular that whatever steps Yukos would have taken, Russia would have found ways to pursue its strategy. Most strongly, in relation to the VAT aspect of the case, the Hulley tribunal observed that: “the Russian Federation was determined to impose the VAT liability on Yukos, and would have done whatever was necessary to

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27 Compared with RosInvestCo and Quasar, the Hulley awards provide a much broader insight into the factual background of the Yukos dispute, dedicating more than 300 pages to describe it. This notwithstanding, the narration of facts and the parties’ respective submissions is far from exhaustive. The Hulley tribunal also noted that the record before it is incomplete in many important respects (see e.g. Hulley, paras. 487 and 639). In addition, the factual and legal determinations made by the Hulley tribunal differ to a certain degree from those made by the RosInvestCo and Quasar tribunals. Whether these discrepancies have been caused by the differences in the file records before the respective tribunals, different lines of argumentation presented by parties or different views from the bench, is not possible to tell with certainty. The author of the present paper has no other familiarity with the Yukos arbitrations than resulting from the generally available awards and decisions. Accordingly, this paper accepts the facts underlying the dispute in such way as they were determined by the Hulley tribunal, while bearing in mind that some elements of the factual pattern were assessed differently by the other Yukos tribunals.

28 Based on the totality of evidence, the Tribunal accepted that Russia’s actions were “only under the guise of taxation, but in reality aim to achieve an entirely unrelated purpose (such as the destruction of a company or the elimination of a political opponent)”, Hulley, paras. 1407 and 1431.
ensure that the VAT liability was imposed on Yukos”. This reasoning was also adopted by the tribunal when it questioned the lawfulness of the fines imposed by Russia on Yukos: “The Tribunal does not accept that, if Yukos had acted as Respondent maintains, it would have been able to escape the imposition of fines. As with the issue of VAT liability, the Tribunal is convinced that had Yukos done so, the Russian Federation would still have found a way or a reason to impose the fines on Yukos.” Such approach, rejecting a priori any specific defence a state might have raised, is explicable and justified only if the tribunal was strongly convinced that the state had acted in bad faith, in a deliberate and orchestrated manner, and that as a consequence, Yukos’ conduct was irrelevant. The tribunal inclusively: “found that President Putin and his administration used Yukos’ tax problems as a pretextual justification for setting in motion a plan to bankrupt Yukos.” The tribunal also accepted witness evidence that “in 2002 Russia created a special unit, called to ‘zanyatsa’ Khodorkovsky. . . ‘take care of’ Khodorkovsky” That unit was allegedly created “to work exclusively on ‘fabricating’ evidence against Mr. Khodorkovsky and Yukos.” The tribunal then referred to the alleged 15 theories which were supposed to be developed and “advanced for public consumption” with the result that the tax evasion charges were accepted as “a plausible pretext for the State apparatus to crush Mr. Khodorkovsky and expropriate Yukos.” The award points to specific developments which seemingly provoked that operation, including the critical comments made by the majority shareholder of Yukos, Mikhail Khodorkovsky about corruption in state-owned businesses in Russia, his increasing support for political opposition to President Putin, as well as the plans to merge Yukos with U.S.-based oil-majors, which could have deprived Russia of an important part of the control over its national strategic assets. These findings were generally consistent with the RosInvestCo and Quasar

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29 Hulley, para. 694.
30 Hulley, para. 750.
31 Hulley, paras. 146 and 767.
32 Hulley, para. 146.
33 Hulley, para. 516.
34 Hulley, paras. 131, 145, 509 and 768.
35 Hulley, paras. 131, 145, 769 and 780.
36 Hulley, paras. 73, 108 (para. 4), 145 and 780.
37 RosInvestCo, para. 630. “As seen above in the consideration of Respondent's measures, these measures in their totality, including but going beyond application of tax law, can only be understood to have had the aim to deprive Yukos from its assets.”
38 Quasar, para. 177: “Based on the extensive record in this proceeding, the Tribunal concludes that Yukos’ tax delinquency was indeed a pretext for seizing Yukos assets and transferring them to Rosneft. As discussed above,
decisions. All the tribunals found that Russia was not acting in good faith to collect taxes, but that it was using and abusing its tax laws in order to destroy Yukos.

Regardless of the conduct of Russia, the Hulley tribunal accepted that Yukos might have contributed to its own demise. Specifically, the Hulley tribunal went on to consider such possible contribution with respect to the following four areas, namely: “i) Yukos’ conduct in some of the low-tax regions; ii) Yukos’ use of the Cyprus-Russia DTA [double-taxation agreement]; iii) Yukos’ conduct in connection with the YNG auction, notably the procuring of a Temporary Restraining Order by a Texas court and the published threat of a “lifetime of litigation”; and iv) Yukos’ conduct in connection with its bankruptcy, notably the non-payment of the A Loan.” 39 Ultimately, the tribunal concluded that among these four instances of possible contribution, the claimants could only be blamed for the conduct of Yukos in the low-tax regions, which also included the use of the Cyprus-Russia double-taxation agreement. The tribunal ruled that: “While […] Respondent’s tax assessments and tax collection efforts against Yukos were not aimed primarily at the collection of taxes, but rather at bankrupting Yukos and facilitating the transfer of its assets to the State, it cannot ignore that Yukos’ tax avoidance arrangements in some of the low-tax regions made it possible for Respondent to invoke and rely on that conduct as a justification of its actions against Mr. Khodorkovsky and Yukos.” 40 The tribunal went on to conclude that: “Claimants should pay a price for Yukos’ abuse of the low-tax regions by some of its trading entities, including its questionable use of the Cyprus-Russia DTA, which contributed in a material way to the prejudice which they subsequently suffered at the hands of the Russian Federation.” 41 With respect to the argument that Yukos abused the Double Taxation Treaty between Cyprus and Russia, the Hulley tribunal noted that “even if there was an abuse by Yukos of that treaty, as in the Tribunal’s prima facie view there was, such conduct would be subsumed into and enlarge the abuse by some of Yukos’ trading companies in some of the low tax regions, which the Tribunal has already found amounted to contributory fault on the part of Yukos.” 42 On the other hand, the tribunal refused to accept that either the conduct of Yukos with respect to the auction of YNG, i.e. its principal production facility, 43 or the failure to repay a bank loan in the context of the threatened bankruptcy proceedings, qualify as contributory fault. With respect to the YNG auction, the Hulley

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39 Hulley, para. 1608.

40 Hulley, para. 1614

41 Hulley, para. 1634.

42 Hulley, para. 1621.

43 YNG was the principal production facility of Yukos, responsible for over 60% of its output (see Hulley, para. 1037).
tribunal acknowledged that Yukos’ acts could have deterred potential bidders and possibly hindered the sale of YNG for a higher price. However, the tribunal attached greater weight to “a series of actions of Respondent before the YNG auction which must have depreciated the auction price very significantly and thus served the Russian Federation objective of acquiring the Yukos assets at a bargain price.”44 Similarly, analysing the conduct of Yukos with respect to the last of the four instances of the possible contributory fault of Yukos, the Tribunal noted that Yukos arguably had assets to repay the loan, the default of which triggered the opening of the bankruptcy proceedings. It concluded, however, that the repayment would not have changed anything, since that loan constituted only a fraction of the overall debt of the company at the time. Moreover, the Hulley tribunal gave credit to the argument of the claimants that since the loan was to be repaid from proceeds from the sale of oil to be produced by YNG, and since the latter was taken over by the Russian-owned Rosneft, the “responsibility for repayment of the A Loan was not theirs or theirs alone.”45

1.3. Two Weaknesses of Hulley Concerning Contributory Fault

The decision of the Hulley tribunal on contributory fault reveals two important weaknesses. The first is its inconsistency with the requirement that the blameable conduct of the injured party should contribute to the injury. As it has been established in the Overview, the concept of contributory fault requires the existence of a genuine factual link between the blameable conduct and the injury, which should be considered in terms of the cause-effect relationship. The flipside of the same requirement implies that the scope of the contribution should be measured by the extent to which the blameable conduct of the injured party impacts the magnitude of the injury. This is the second weakness of the tribunal’s decision. As shall be shown, the Hulley tribunal’s finding that the use of the potentially abusive tax structure contributed to the claimants’ injury of USD 16.7 billion cannot be defended under the determinations made by the tribunal elsewhere in the Hulley awards.

1.3.1. Lack of Causality

The argument concerning the lack of causality is straightforward. The Hulley tribunal’s determination that the use of the potentially abusive tax structure by Yukos contributed in a material and significant way to the treatment the company received at the hands of the Russian Federation is materially inconsistent with the core determination of the Hulley awards that the tax issue was merely a pretext for Russia to expropriate Yukos. If the tax issue was a pretext, it cannot be regarded at the same time as a genuine reason that contributed significantly and materially to the expropriation. Moreover, the tribunal gave credibility to a witness statement that in 2003 a special unit was created in

44 Hulley, para. 1627.
45 Hulley, para. 1630.
Russia and charged with the task to fabricate evidence against Yukos.\footnote{Hulley, para. 146.} If this had been the case, it would have been logical to accept also that even if the tax structures used by Yukos had been entirely transparent and lawful, there is considerable probability that the state would have relied on the fabricated evidence it had ordered, or pursued Yukos by different means developed by the alleged special unit. Either way, the correctness of the tax structure would not matter. Since the tribunal accepted in the award that the predetermined goal of Russia was to take over the assets of Yukos with no compensation, the aim would have been achieved one way or another. Accordingly, it is difficult to accept that investors could be apportioned with a significant portion of blame for the Russia’s choice of its anti-Yukos strategy. Accordingly, there is no causal link between the tax structure used by Yukos and the injury. The same criticism extends to the considerations related to the alleged abuse of the Cyprus-Russia double taxation treaty.

1.3.2. Possible Impact of Blameable Conduct on the Injury

The analysis of the possible impact of the use of the potentially abusive tax structure of Yukos on its injury calls for a series of preliminary observations. First, if the tax proceedings were merely a pretext to expropriate Yukos, as found by the \textit{Hulley} tribunal, the impact of the tax structure on the destruction of Yukos should be accepted as nil. Second, even if the conduct of Russia had genuinely been caused by the abusive tax conduct of Yukos, the clearly disproportionate reaction of Russia would have trumped the implications of causality between the injury and the blameable conduct of Yukos (see below, Section 2.1). Third, the obligation of Yukos to pay Russian taxes has nothing to do either with the problem of the international responsibility of Russia for the expropriation of Yukos, or with the concept of contributory fault. If Yukos had evaded its obligation to pay taxes in Russia, it was legitimate for Russia to levy those unpaid taxes along with any accompanying charges and/or fines. In that respect, there is neither an internationally wrongful act of Russia, nor - by consequence - no contributory fault of Yukos. There is simply an obligation to pay due taxes. For each of the three reasons, the analysis of the financial implications of the use of the tax structure by Yukos on its injury is conceptually mistaken.

Therefore, the following analysis is illustrative only. It shows, however, that the hypothetical impact of Russia’s legitimate sanction on Yukos on account of the tax structure in question, would have had a significantly lower impact on the financial situation of the company than the USD 16.7 billion determined by the tribunal as a measure of the contributory fault of the claimants. This analysis requires two preliminary determinations. The first determination is whether the tax structure in question effectively violated Russian tax law. The assessment of the Yukos tax arrears and imposition of fines were made by the Russian authorities in the domestic tax proceedings on the basis of legal theories of the bad-faith taxpayer, abuse of tax law and re-attribution, which were either invented for
the purposes of the Yukos case, applied in a novel manner, or untested in tax courts. Accordingly, the question whether Yukos had avoided taxes in Russia hinged upon the question whether the legal theories relied upon by Russia were themselves in accordance with the then binding Russian law. Only if the tax structure in question had run afoul of Russian law, would it have been possible for Russia to apply legitimate sanctions against Yukos. The second required determination thus turns around the question of what sanctions Russia could have legitimately applied against Yukos in order not to breach the Energy Charter Treaty.

An attempt to answer these questions in a definite manner would clearly exceed the scope of the present paper. Moreover, it seems that the position of various Yukos tribunals is not entirely consistent on these two determinations. To the Quasar tribunal Yukos was simply engaged in tax optimization, which was seen a legitimate business strategy “in a world filled with major corporations openly structuring their businesses through low-tax jurisdictions”.47 The tribunal rejected the proposition that the transactions involving Yukos and the companies based in low-tax jurisdictions were sham. The Quasar tribunal saw this problem possibly as one of transfer pricing and was of the opinion that if Russia had been set to combat the operations of Yukos, it should have done so from the angle of transfer pricing (i.e. by ex-post determination of the actual market price). The Quasar tribunal did not accept Russia’s reliance on the abuse-of-law doctrine or the bad-faith-taxpayer doctrine. Accordingly, it refused to accept as lawful any of the tax measures applied by Russia. The RosInvestCo tribunal also rejected the plea of legality of the tax measures applied by Russia. It concluded in particular that “the subsequent re-application of amorphous principles of ‘good faith’ and ‘proportionality’ with fluid levels of investment to be made in the Low Tax Regions are a weak defence by Respondent”48, and was not ready to accept them. While the RosInvestCo tribunal noted the problem with Yukos’ use of tax structures based in the low-tax regions, it did not indicate what consequences should be drawn from that fact.

The legality of Russian tax assessments was also reviewed by the European Court of Human Rights. The ECtHR generally approved the determination of the Russian tax authorities that the tax scheme used by Yukos was unlawful. The ECtHR also refused to declare that the tax re-assessments made by the Russian Federation for fiscal years 2001-200349 were inconsistent with the European

47 Quasar, para. 74.

48 RosInvestCo, para. 620(b).

49 Case of OAO Neftyanaya Kompaniya Yukos v. Russia, (Application no. 14902/04), judgment of 20 September 2011, para. 590: “the Court has little doubt that the factual conclusions of the domestic courts in the Tax Assessment proceedings 2000-2003 were sound. […] The applicant company itself did not give any plausible alternative interpretation of this rather unambiguous evidence, as examined and accepted by the domestic courts”. See also para. 594, where the ECTHR held that “the findings of the domestic courts that applicant
Convention of Human Rights. The Court also refused to acknowledge the imposition of the VAT arrears on Yukos as a breach of the Convention. 50 It should be emphasized that while the ECtHR reviewed the procedure that led to the imposition of tax-arrears upon Yukos in the fiscal year 2000, and found it in breach of the European Convention of Human Rights, it did not, presumably for reasons of the limits of the application, carry out the same analysis for the fiscal years 2001-2003. On the other hand, the ECtHR held that the re-assessment of taxes done in 2004 with respect to the fiscal year 2000 was time-barred, and that the Russia’s steps to justify those assessments were taken in breach of Article 6 51 and Article 1 of Protocol No. 1 52 of the European Convention of Human Rights. This may indicate that both the re-assessments for the fiscal year 2000 and the repeated offender’s fines for 2001 would not have been applied in a no-breach scenario.

The Hulley tribunal took a yet another position. With respect to the VAT sanctions and the fines for “wilful” and “repeated” offenders it found that they were imposed in breach of Russia’s obligation under the Energy Charter Treaty. However, with respect to the other taxes, the tribunal’s position was more attenuated, but eventually inconclusive. Upon consideration, the Hulley awards may be read as an implied acceptance from the tribunal that it might have been possible for Russia to charge Yukos with certain taxes and interest on them. This would include the tax on profits, property tax, road users tax, advertising tax, tax on sales of combustibles and maintenance tax. 53 Although the Hulley tribunal abstained from making any definite determinations, it ultimately accepted that “Yukos was vulnerable on some aspects of its tax optimization scheme, and possibly even would have faced “substantial tax claims” that might have resulted in “significant losses,” principally because of the sham-like nature of some elements of its operations in at least some of the low-tax regions”. 54 Accordingly, for purposes of the following analysis, it is assumed that the assessments made by the Russian authorities with respect to these taxes constitute a cap of the potential legitimate liability of Yukos because of its tax structure.

The overall amount of re-assessed tax liabilities imposed upon Yukos by the Russian tax authorities, including interest and fines, amounted to USD 10.589 billion. 55 Within that figure, the

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50 OAO Neftyanaya Kompaniya Yukos v. Russia, para. 602.
51 OAO Neftyanaya Kompaniya Yukos v. Russia, paras. 540, 548 and 551.
52 OAO Neftyanaya Kompaniya Yukos v. Russia, paras. 574 and 575.
53 Hulley, para. 581.
54 Hulley, para. 515.
55 Hulley awards, para. 581.
principal liability is understood to amount to USD 5.17 billion and the interest and fines amount to USD 5.42 billion. The Hulley awards do not provide a further split between interest and fines. Moreover, the determination of the overall tax debt amounts of Yukos across the award is not fully consistent, as evidenced by the comparison of paras. 581, 589 and 599 of the Hulley awards. The Hulley tribunal did not state that it agreed with the re-assessment carried out by the Russian Federation in whole, although it noted that Yukos’ potential infringements of the Russian tax law could have led to substantial assessments. A number of conclusions made by the Hulley award should be taken into account in this respect. First, the tribunal rejected most of the fines as a lawful remedy. Second, it pointed to a rather broad-brush approach of the Russian tax authorities in some respects, for example with respect to Yukos’ operations in Mordovia. Third, the awards indicate that the judicial review of the tax assessments in Russia was reportedly done pro forma and was tainted with irregularities such as denial of extensive motions for evidence, superficial review of documents and breaches of due process, which make that judicial assessment an unreliable basis for a determination from an international law tribunal. Accordingly, on the basis of the tribunal’s own findings the justifiable amount of Yukos re-assessed tax arrears is likely to have been much lower than USD 10.6 billion. It should be noted, for example, that if the 2000 tax liabilities were time-barred in 2004, as declared by the European Court of Human Rights, they should have never been applied to Yukos. On the other hand, while the ECtHR judgment approved the outcome of the tax proceedings against Yukos for fiscal years 2001-2003, it did not evaluate the procedural aspects of those proceedings. This may be an important factor qualifying the authoritative strength of the ECtHR judgment. If the tax proceedings may have been tainted with serious irregularities, as the Hulley awards suggest, the Court’s analysis focused solely on the outcome of those proceedings may not lead to reliable conclusions.

Furthermore, the Hulley awards indicate that tax problems were settled contemporaneously by other Russian and foreign companies, including YNG, for a fraction of their face value, ranging from 11 to 30 %. The lack of Yukos’ similar treatment was found by the tribunal to be one of the major

56 Hulley, paras. 589.
57 Hulley, para. 515.
58 Hulley, paras. 703 et seq.
59 Hulley, para. 639.
60 See e.g. Hulley, para. 1083.
61 Hulley, paras. 967-968. The 11 % ratio refers to the waiver of 89 % of fines with respect to YNG after its acquisition by Rosneft. The 30 % ratio corresponds to the USD 300 million payment made by Sibneft to settle a USD 1 billion dollar tax claim.
indicia of its expropriatory treatment.62 This could mean that in a hypothetical no-breach scenario, in a situation free from expropriation, Yukos’ tax arrears could have been similarly reduced. By implication, even assuming the unlikely scenario that the re-assessed liability of USD 10.6 billion had been fully legitimate, a company in Yukos’ position in a no-breach scenario could get away with a payment of something between USD 1.16 billion to 3.18 billion, representing the range of 11% to 30% of USD 10.6 billion. Of course, this calculation remains hypothetical and speculative. In particular, it could be argued that the reduction of the tax claim to 11% in the case of YNG was exceptional, because; (1) the tax debt was created in a seemingly artificial way shortly before the auction of the YNG, in order to depress the valuation of the company, and (2) the settlement was entered into shortly after YNG was taken over by Rosneft, and hence by the Russian Federation. On the other hand, it could likewise be argued that the tax claim was made against YNG at the time when it was still a part of Yukos, so its strength and soundness may be similar to other tax claims made against Yukos at that time. In any event, since the reduction of the tax arrears to 11% was a fact, this figure can be used as a genuine reference value (even if not the most probable) for the analysis of the possible outcome which the Yukos tax dispute would have had in a no-breach scenario.63

However, the purpose of this argument does not consist in the determination of the hypothetical value, by which Yukos could have managed to settle its claim in an imaginary perfect world. Rather, the argument seeks to show that it was at least possible that the reduction of the tax debt through settlement could have occurred and that it would have been significant. This is not without effect of the Hulley tribunal’s decision on contributory fault. Notably, the point to be made from these observations is that the financial outcome of the tribunal’s decision on contributory fault is much harsher for the claimants than the hypothetical sanction Yukos would have faced had Russia applied its tax laws in accordance with its international obligations and if a settlement had been reached in the tax dispute between Yukos and Russia. As a matter of pure fact, the effect of the contributory fault decision of the Tribunal, USD 16.7 billion,64 is USD 6 billion more than the total nominal amount of the re-assessments made by Russia, an important part of which is probably questionable. If one also takes into account that the claimants’ stake represented only 70.5% of the

62 Hulley, paras. 975-980. However, it should be noted that both the Hulley tribunal (para. 976) and the European Court of Human Rights in the OAO Neftyanaya Kompaniya Yukos v. Russia 2001 judgment, (para. 615) held that there was not enough data to decide whether the case of Yukos was comparable (for purposes of analysis of possible discrimination), with those other cases.

63 It could also be added that the Hulley awards also refer to the reported waiver of multi-million tax liabilities of a multinational oil company in Russia (see para. 967). While the lack of more accurate figures compromises the usefulness of that example to this analysis, it is another confirmation for the thesis that a significant reduction of the tax claim by way of a settlement with the tax authorities was possible.

64 Hulley, Exhibit A-6, Table 1.
shares in Yukos, the difference between the financial impact of the Hulley tribunal’s decision on contributory fault and the hypothetical share the claimants would have had to bear if Russia had imposed legitimate tax sanctions on Yukos, may be very significant.

2. Is There Room for Contributory Fault in Hulley?

The present section explains why the contributory fault doctrine should not have been applied at all in the Yukos case. This is done in two sections. The first section deals with the analysis of the other instances of possible contributory conduct of Yukos analysed in the Hulley awards. The second section deals with the acts of Yukos and its managers that have a clear factual link with the injury suffered by the claimants.

2.1. Potential Contributory Conduct of Yukos Rejected by the Tribunal

Similar criticism on the point of causality, which is addressed to the tribunal’s determination of the contributory effect of Yukos’ use of the tax structure, should be extended to the other instances of possible contributory fault analysed by the tribunal. This applies to the conduct of Yukos related to the repayment of the A loan and the opening of the bankruptcy proceedings. The relevant developments took place in 2005 and 2006. Therefore, it should be noted that the Hulley tribunal elsewhere held that: “the expropriation of Claimants’ investment was crossed earlier than in November 2007. On the basis of the record, it is clear to the Tribunal that a substantial and irreversible deprivation of Claimants’ assets occurred on 19 December 2004, the date of the YNG auction [...] The date of the expropriation of Claimants’ investment is therefore determined by the Tribunal to be 19 December 2004.” Hence, it is not at all clear why the tribunal considered the conduct of Yukos in 2005 and 2006 in terms of potential contributory fault. From a purely chronological and logical perspective, the acts under consideration occurred after the expropriation had taken place and hence after the corresponding injury was inflicted.

The second problem with the approach taken by the tribunal is its failure to appreciate the logical consequences of the orchestration theory. The Hulley tribunal determined that Yukos might have been absolved for not having repaid the loan under the facts of the case, and that the repayment of the loan would not have changed its situation given the overall amount of debt it was facing. It failed to consider whether the conduct of Yukos mattered at all given the fact that - as the tribunal held - the Russian Federation was set to declare Yukos bankrupt and appropriate its assets. On such basis, it does not seem probable that Yukos could have avoided the opening of the bankruptcy proceedings by way of the company’s dealing with its foreign creditors.

The foregoing reservations apply also to the tribunal’s reasoning with respect to the auction of YNG, which took place on 19 December 2004. From a chronological perspective, assuming that the

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65 Hulley, para. 1762.
The auction of YNG was the critical point in the process of the creeping expropriation of Yukos. The die was cast for Yukos at the latest by the time the auction was announced. The importance of YNG according to the *Hulley* award was due to the fact that it was the main production facility of Yukos, responsible for 60% of its output. It may be inferred that as long as Yukos had this production capacity, it was able to engage in an endless tax battle with the Russian Federation. As the Russian tax authorities would produce new tax assessments, YNG would produce more revenue for Yukos to repay them. Russia avoided this conundrum precisely by way of seizing YNG as the first step of the enforcement process, which was put up for forced sale, even though Yukos was already in the process of repayment of its outstanding tax debt. Accordingly, the tribunal’s question about who contributed to the seemingly undervalued sale of YNG, is ill-posed. The critical issue was not the price. This can be shown easily by reference to the fact that the overall amount of debts generated by Russia and ultimately presented against Yukos in the bankruptcy proceedings largely exceeded the value of its assets. The orchestration theory, adopted by the tribunal, also implies that the amount of the tax debt imposed on Yukos could have been increased depending solely on Russia, e.g. by imposition of new fines or assessments. The critical issue was hence the importance of YNG for the ability of Yukos to generate cash-flow and keep fighting the legal battle, the conditions of which were unilaterally set by the state.66 This consideration seems to lie at the heart of the convincing determination of the tribunal that the auction of YNG was the central event in the process of the creeping expropriation of Yukos. Therefore, the desperate defence of Yukos against that auction, including the “lifetime of litigation” campaign,67 or the institution of the bankruptcy proceedings in Texas68 is understandable. Turning to the question of the price for which YNG was sold, the tribunal correctly determined that Russia was ultimately responsible for taking actions to decrease the price.69 It could only be added that the explanation for this apparently counter-logical proposition can be found elsewhere in the *Hulley* award, notably in President Putin’s remark on the acquisition of YNG by Rosneft: “today, the state, resorting to absolutely legal market mechanisms, is looking after its own interests”.70 In para. 1472 of the *Hulley* award, the tribunal emphasised that the Russian state directed both the auction and the acts of Rosneft with respect to the acquisition of YNG. Hence, if Russia was set to re-nationalize YNG through the auction, it was clearly not interested in raising the price. Ultimately, in accordance with the logic of the *Hulley* awards, the sense of the YNG auction for Russia consisted in the purchase of private property with state-owned money of Rosneft in repayment of the artificially created tax-debt of

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67 *Hulley*, para. 995.

68 *Hulley*, para. 1001.

69 *Hulley*, para. 1629.

70 *Hulley*, Claimants’ Skeleton, para. 43, at p. 27 of the award.
Yukos. The conclusion is that Russia was clawing back its most valuable oil-producing entity for free. At the same time, it was destroying the main source of revenue of Yukos, thus condemning it to bankruptcy or at least significant downsizing. Accordingly, the tribunal rightly ruled that the conduct of Yukos concerning the auction of YNG did not contribute to its injury, but the reasoning does not seem to adequately explain why.

2.2. Other Potential Contributory Conduct of Yukos and its Owners

The foregoing sections of this paper show that the four instances of conduct of Yukos, which were analysed by the Hulley tribunal, could not be regarded in terms of contributory fault, principally because of the lack of factual link between that conduct and the injury caused by the acts of Russia. The present section extends the analysis into other areas of Yukos’ and its owners’ conduct, which show clear links with the ultimate outcome of Yukos. These include: (1) the acts of Mr. Khodorkovsky that provoked the anti-Yukos campaign of the Russian Federation, (2) engagement in a full-scale hostile battle with the state, and (3) moving assets away from the reach of tax enforcement measures. It is further shown that for various reasons, none of these instances should have triggered the application of contributory fault.

2.2.1. Conduct of Mr. Khodorkovsky

The Hulley tribunal determined that the conduct of Russia towards Yukos was the consequence of specific acts of Mr. Khodorkovsky, the principal shareholder and Chief Executive Officer of Yukos in late 2002 and early 2003. These acts consisted in the public criticism of corruption in the state-owned sector, his support for the political opposition and merger plans that would give away a significant degree of control over Russia’s strategic assets into foreign hands. Hence, on a purely factual plane, there seems to be a clear cause-effect relationship required by the concept of contributory fault.

However, this does not answer the question whether the conduct of Mr. Khodorkovsky could be regarded as blameable, which is a separate requirement of contributory fault. As noted at the outset, the traditional criteria of blameable conduct are rather ample and vague, and Article 39 ARSIWA requires that the conduct in question be either wilful or negligent. Against these criteria, there is probably more than one possible qualification of Mr. Khodorkovsky’s behaviour. On the one hand, it could be argued that there was nothing blameable in the acts of a man who criticises corruption in his home country, makes free political choices and contemplates international commercial transactions that manifest the exercise of economic freedom and foster international trade and investment. Indeed, these concepts are strongly rooted in the principles of international legal order and international law instruments adopted to combat corruption in World Duty Free v. Kenya, ICSID Case No. ARB/00/7, para. 142 et seq., including a review of international law instruments adopted to combat corruption and Metal-Tech Ltd. v. Republic of Uzbekistan (ICSID Case No. 20
instruments of human rights. Certainly, it has not been established that any form of his activity in this respect was in breach of the applicable Russian law. From that perspective, Mr. Khodorkovsky’s conduct could be regarded as perfectly innocent, hence precluding the applicability of contributory fault.

However, it could also be argued that negligence is not an abstract concept and it needs to be assessed always with regard to the given circumstances. In this context, the principals of Yukos could have expected that an active engagement in support of the opposition could have caused Mr. Khodorkovsky’s fall into disfavour with the Kremlin and that it could have grave consequences for the company. At that time, the internal political situation in Russia was already becoming delicate. Oil and other natural resources of conventional energy were the principal sources of national wealth and, at the same time, the strategic instruments of Russia’s international politics. This was also the very environment in which Yukos grew to become the largest Russian producer of oil and one of the largest oil companies worldwide. It is a fact of life that in a political environment like this, it is not possible to grow to such extent or maintain such holding without implicit or express blessing from the ruling power. That reality was displayed in front of the Yukos tribunal when it reported the words of President Putin in response to the volte-face of Mr. Khodorkovsky: “So he said that after protecting Mr Khodorkovsky for some time—now it’s almost a quotation—“I decided and I stepped aside to allow Mr Khodorkovsky to solve his problems with the boys by himself.” . . . “so Mr Khodorkovsky has chosen to fight. Okay,” said Mr Putin, “if he has chosen to fight, let him to fight and we’ll see

ARB/10/3, Award of 4 October 2013, para. 291, referring to the 1996 Inter-American Convention against Corruption (not binding upon Russia); the 1997 OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (acceded to by Russia in 2012); the 1999 Council of Europe Civil Law Convention on Corruption; the 1999 Criminal Law Convention on Corruption (signed by Russia in 1999, in force from 2007) and the 1999 Civil Law Convention on Corruption (not binding Russia), both adopted under the aegis of the Council of Europe; the 2003 African Union Convention on Preventing and Combating Corruption (not binding Russia); and the 2004 UN Convention against Corruption (signed by Russia in 2003, in force since 2006)). The progressing accession of Russia to these instruments actually shows that the conduct of Mr. Khodorkovsky was consistent with the official line taken by the Russian Federation, both at the time of the events and thereafter. With respect to the broader issue of fight against corruption as part of the international public policy, the intensified efforts taken in the last years by many states, including the U.S. and the U.K. to eradicate corruption in international business transactions stands to confirm the importance of this issue. In this context, the World Duty Free and the Metal-Tech awards seem to correctly identify the fight against corruption as part of international public policy, and possibly also of customary international law.

72 E.g. Article 19(2) of the International Covenant on Civil and Political Rights: “Everyone shall have the right to freedom of expression; this right shall include freedom to seek, receive and impart information and ideas of all kinds, regardless of frontiers, either orally, in writing or in print, in the form of art, or through any other media of his choice.”
There is apparently no coincidence in that as long as Yukos did not oppose the government, it was undisturbed in its use of the corporate structures located in the low-tax zones, but that the tax proceedings began once its political protection was removed.

The situation, as described, is interesting from an international law perspective. It could be analysed in two distinct contexts. On the one hand, a highly affluent, foreign-controlled company of a strategic position may require highest political protection in some countries, especially where the rule of law is not fully developed, law enforcement is inadequate and/or informal structures running the state yield more power than the official ones. To the extent the company does not breach the domestic law of that state (nor any other rule applicable to it), there does not seem to be any reason, why the company should not seek to secure such protection. When the protection is removed and the company becomes subject to various attacks, it will be relevant whether these attacks come from the state or from third parties. Questions of international responsibility of the state in such circumstances will turn on general principles, including the issues of attribution and/or the lawfulness of the state’s conduct. Interestingly, as long as the special protection is extended, the treatment of the company may actually surpass the standard of protection to which the host state may be obliged under international law instruments. Therefore, once the protection is removed, the investor would not necessarily be able to establish or prove a breach of an international law obligation by the host state, even when the treatment it receives at the hands of the host state deteriorates. A distinct situation would occur when a company violates or abuses domestic law but secures, through favourable political connections, that the law is not enforced against it. It should generally be accepted that neither the company nor the investor that controls it, acquire legitimate expectations that the law would never be enforced, nor should the state be held in breach of international law when it moves to do so. Nonetheless, the entitlement of the state to enforce its own laws does not give it a carte blanche to mistreat the investor, which is the essence of the Yukos case.

The point here, however, is whether Yukos was negligent in risking its relationship with the Kremlin by engaging into the anti-Putin campaign. Since Yukos was a public company with its shares traded and held by various investors in Russia and abroad, the management of Yukos was under a defined legal and professional duty to look after the interests of the shareholders and protect the value of their shareholding. Involvement of the company in a political game, in the specific Russian environment, certainly did not advance those interests. Moreover, the conduct of Mr. Khodorkovsky, as described in the award, was voluntary. There were no external circumstances which compelled him

73 Hulley, para. 145. Also: “It signalled the ‘gloves [had come] off,’ and that Mr. Khodorkovsky was no longer tolerated”, Hulley, para. 145.

74 Jan Oostergetel and Theodora Laurentius v. The Slovak Republic, UNCITRAL, Final Award of 23 April 2012, paras. 254 and 269.
to act in the way he did. According, it could be argued that his conduct, while not necessary from a business perspective, exposed the company and the interests of the shareholders to the risk of a negative response from the Russian Federation. From that perspective, which could, for example, be the view of passive, politically neutral, foreign shareholders, including financial institutions interested in proper management and return on investment, rather than in Russia’s internal politics, the conduct of Mr. Khodorkovsky could possibly be claimed to be negligent.

However, even if the original conduct of Mr. Khodorkovsky could have been qualified as blameable, at least from a certain perspective, the degree of Russia’s excesses in response to that conduct would deprive the acts of Mr. Khodorkovsky of any relevance. This approach is consistent with the traditional position under customary international law that the reaction of the state that is clearly disproportionate to the conduct of an individual, turns into the exclusive cause of the injury. In this context, cases such as Mallen, Cerruti and Santangelo are referred to as relevant examples. In Mallen,77 the reparations for the brutal and violent conduct of a law enforcement officer were not reduced on account of the fact that this conduct was taken because of the allegedly unlawful act of the victim. In Cerruti,78 the seizure of assets was declared to be an inadequate response to the previous unlawful conduct of an alien who should rather have been sanctioned with an expulsion or a criminal sentence. In Santangelo, the expulsion of a naturalized U.S. national for publications perceived to ridicule Mexico, provoked a high damages award as the expulsion was clearly disproportionate to the putative offence in question and because it was carried out in very harsh terms.79 From a theoretical perspective, the proposition that a disproportionate reaction of the state becomes the exclusive cause of the injury results logically from the principle that there must be a causal link between the conduct of

75 This is important, as Ripinsky and Williams show that duress may preclude the applicability of contributory fault, S. Ripinsky, K. Williams, Damages..., p. 318, with reference to CME v. Czech Republic, Partial Award, para. 579.

76 B. Stern, Le préjudice..., p. 322: “Si les mesures prises par l’État à l’encontre de l’étranger sont sans commune mesure avec la conduite de ce dernier, l’attitude de l’État apparaît alors comme totalement injustifiée et doit par conséquent, être considérée comme la cause exclusive du dommage subi par l’étranger; malgré la conduite fautive de la victime, l’État devra donc réparer l’intégralité du préjudice qu’il lui a infligé; dans un cas de se genre, la conduite de la victime n’est absolument pas prise en considération pour l’établissement du montant de la réparation, car elle est considérée comme totalement étrangère à la production du dommage.”

77 R.I.A.A. Vol. IV, p. 177.


the individual and the injury. In cases of clearly disproportionate actions, the injury results entirely from the excesses of the state - for which the individual is not responsible - rather than from the original blameable conduct of that individual.

Finally, if the conduct of Russia is seen as a response to the political and business activism of Mr. Khodorkovsky, and not as a response to an abusive tax scheme, it is not even appropriate to look at the Yukos case through the lens of proportionality. There should be a difference in the treatment of a situation in which the state would genuinely fight an alleged tax scheme with disproportionate tax measures, and a situation in which massive tax measures are applied in order to combat an activity which is not unlawful, but unwelcome for political reasons. In the first case the question of proportionality is genuine as it revolves around the lawfulness of sanctions provided for and applied under domestic law in response to conduct prohibited under that law (such as tax abuse or tax evasion). In the second case the problem consists in the effects of sanctions which were applied in response to the conduct that was not unlawful under domestic law, and for which no sanctions were provided in that law. Accordingly, the reaction is not only disproportionate, but it is also arbitrary. It may also be considered as a violation of other standards of treatment, including the minimum standard of treatment or the fair and equitable treatment.

2.2.2. Dispute Resolution Strategy of Yukos

The second area in which the conduct of Yukos could be explored from the angle of contributory fault, is the dispute resolution strategy adopted by the company in response to the tax assessments and tax enforcement measures. The Hulley awards reveal that the company engaged in a full and aggressive battle, involving appeals, moving of assets, recourse to foreign courts (with the prominent example of the proceedings before bankruptcy courts in Texas) and advertising campaigns threatening tentative purchasers of YNG with a “lifetime of litigation”. It is at least possible that this type of reaction to the measures applied by Russia was a catalyst of even more hostile response of the state, and hence contributed to the ultimate fate of Yukos. According to that logic, a more compliant approach, more akin to the Canossa walk, could possibly have stopped Russia or unwound the measures already taken.

80 In the view of the author this situation would correspond to the characterisation of arbitrariness offered by the ICJ in the Case concerning Elettronica Sicula S.p.A. (ELSI) (United States of America v. Italy), Judgment of ICJ of 20 July 1989, I.C.J. Reports 1989, p.76: “Arbitrariness is not so much something opposed to a rule of law, as something opposed to the rule of law: [...] It is a wilful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety”. This description would apply to a situation where the state does not apply its laws, but merely pretends to do this, while in fact it proceeds to sanction a conduct which is not prohibited under its laws. This is nothing else but the “wilful disregard of due process of law”.

24
This hypothesis prompts questions whether the theory is accurate or probable and whether a particular dispute resolution strategy may at all be regarded as blameable conduct. On the first of these points it should be observed that the Hulley awards do not provide the full picture of the mammoth-scale litigation between Yukos and Russia. Accordingly, it is not possible even to assess whether the dispute resolution strategy of the company actually was disproportionately aggressive in the circumstances of the case. What is known, however, is that the Hulley award dedicates a considerable amount of attention to the attempts of Yukos to settle the case, at a price of USD 8 billion, and ultimately USD 21 billion.81 This may indicate that even a Canossa walk could not have reversed the course of events once the campaign against Yukos started, and that the state was not prepared to stop short of expropriating Yukos at any price.

With respect to the question whether a particular dispute resolution strategy could be blameable, a lawyerly-principled position would be that the exercise of available legal recourses does not constitute an abuse of law and cannot be seen as blameable. A more pragmatic, business-wise approach, however, would be to consider whether the acceptance of a hair-cut, even a significant one, would not be a better solution than risking ultimate defeat in a legal battle. Here, again, the account in the Hulley awards that Russia persistently rejected all settlement offers made by Yukos seems to imply that a tough legal battle may have been the only available option.

2.2.3. Removal of Assets from Enforcement Proceedings

The third important area of the company’s potential contribution is concerned with the alleged steps taken by Yukos in the course of the tax enforcement proceedings in order to remove assets from the reach of the Russian authorities.82 This was noted, in particular, by the Quasar tribunal who called it a “perfectly understandable reaction would be to save what could be saved of what is, after all, presumptively the property of any corporate entity's owners”.83 In this respect, two observations seem to be pertinent. First, it is possible that the conduct of the Yukos owners moving the assets away in response to the conduct of the state, contributed to the ultimate demise of the company and the pace

81 Hulley, paras. 899 et seq. See in particular paras. 929-931, referring to approximately 80 settlement proposals and attempts of communication on the part of the company, which were not responded to by the Russian Federation.

82 Hulley, para. 1283 and 1810: “The Tribunal notes that even after the tax assessments at issue in the present arbitration were issued, Claimants and their owners were able to divert money earned by Yukos out of Yukos, and into the two Stichtings,2418 and therefore away from the tax authorities. The Tribunal cannot exclude the possibility that, but for the expropriation, the very same mechanism would have been resorted to by Claimants under different circumstances to divert some of the money earned by Yukos.” In such case, however, that diversion of funds would have been reflected in the fair market value of Yukos.

83 Quasar, para. 123.
thereof. Given that the company’s assets were being liquidated not only through tax enforcement proceedings, but also through the acts of the company itself, its equity value was decreasing at an even faster rate. Yet in the light of the Hulley tribunal’s determination that Russia intended to expropriate Yukos, a passive approach of the shareholders and managers of the company would not have saved it. Hence, although the conduct of Yukos was not without the influence on the actual insolvency of the company, a causal link between the conduct and the injury cannot be established. However, as shall be shown in the next section, that conduct should not be without consequences regarding the level of damages.

3. Consequences of the Yukos Conduct on the Damages Due to Claimants

As shown in the preceding sections of this paper, the facts in the Hulley case did not justify the application of contributory fault. The same facts, however, do warrant the conclusion that certain conduct of Yukos should have its consequences in the amount of damages that was due to the claimants. This applies to at least two areas: (1) tax implications of the tax structure used by Yukos if the structure had been in breach of the Russian law, and (2) value of assets protected by the Yukos owners from the enforcement proceedings.\(^{84}\) In either case, however, the basis for the reduction of damages would be different than the concept of contributory fault.

3.1. Legitimate Tax Claims Should Impact the Fair Market Value Analysis

This paper holds the firm position that the legitimate tax claims of Russia should have been paid by Yukos regardless of whether the former had expropriated the company. Accordingly, even in a no-breach scenario, the value of the legitimate tax claims would have impacted the value of the company. Since Russia effectively proceeded to collect these taxes, the eventuality of the tax proceedings against Yukos should have been taken into account in projecting the fair market value of the company in the no-breach scenario. This proposition is further supported by other observations made by the Hulley award, namely that the tax incentives which lay at the heart of the questionable tax structure used by Russia were abolished as of 2004 and that other companies faced similar tax claims at the same time. Accordingly, the projection of the hypothetical fair market value of Yukos in the situation Russia had complied with international law, should have allowed for a deduction of the value of legitimate tax claims due from Yukos, together with interest and other applicable charges. Such projection would possibly have to take into account the outflow of tax arrears and its implications for the cash flow within the company, such as an increased demand for capital and related costs of financing it.

\(^{84}\) Such possibility was accepted by the claimants in Quasar: “The Claimants, for their part, recognize that the Tribunal may adjust Professor Ruback's model by subtracting any taxes that were legitimately owed by Yukos and any Yukos assets that were removed from Russia by Yukos’ majority shareholders and managers.” Quasar, para. 211.
As noted above, making such projection would first require resolution of two salient issues related to the legality of the tax structure used by Yukos, and the amount of the tax claims that international law would accept as legitimate. Regrettably, the Hulley tribunal noted that it did: “not need to determine, as a matter of Russian law, whether any of the activities of the Yukos trading companies in the low tax regions in 2000, 2001, 2002, and 2003 in the implementation of its tax optimization scheme were in violation of this doctrine [i.e. bad faith taxpayer] … It is not the role of the Tribunal in the present arbitrations to sit as a court applying Russian law.”\(^85\) However, while the approach of the tribunal was justifiable as far as the question of Russia’s liability was concerned, the need to make the corresponding determinations came back as a part of the analysis on quantum. The analysis on damages in the Hulley awards does not confirm, however, that any such determination was carried out.

### 3.2. Deduction on Account of ‘Saved’ Assets

A different deduction from the amount ultimately awarded to the claimants should probably have been made on account of the assets the Yukos owners managed to protect against the enforcement measures by the Russian state. The Hulley awards shows that various operations, including the creation of Dutch law stichtings, were carried out allegedly in order to escape Russian enforcement measures.\(^86\) Whatever the motivation of those operations was, the Hulley awards imply that some of the assets were effectively removed by the Yukos owners, presumably including the claimants. If this was the case then it is clear that the value of those assets cannot count as damages of the claimants. Accordingly, once the hypothetical fair market value of Yukos would have been established, allowing for deduction of legitimate tax claims (if any), the amount of damages should further be decreased by the value of the assets that the claimants managed to save from expropriation.

### 3.3. Theory Underpinning the Deductions

The suggested corrections to the amount of damages have a clear basis in the Chorzów Factory formula, which requires not only to “wipe out all the consequences of the illegal act”, but also to “re-establish the situation which would, in all probability, have existed if that act had not been committed”.\(^87\) In the circumstances of the Yukos case this would imply that if the internationally wrongful act had not been committed, the company would not have become bankrupt. However, it would still have had to face its tax liability. At the same time, the shareholders of that company would have had no motivation to deprive it of its assets, as they apparently did in the course of the enforcement proceedings. Even if the shareholders had intended to remove certain assets from Yukos

\(^85\) Hulley, para. 499. A similar position was taken by the RosInvestCo tribunal, who also refused to sit as “an appeal body for the determination of Russian tax law”, RosInvestCo, paras. 446 and 489.

\(^86\) Hulley, paras. 1054 et seq.

\(^87\) Case concerning Chorzów Factory (Claim for indemnity) (Merits); P.C.I.J., 1928, Series A, No. 17, p 47.
this fact would still have to be reflected in the projection of the hypothetical fair market value of that company.

4. Wider Consideration of the Hulley Awards for Contributory Fault

Apart from the considerations that are strictly related to the facts of the Yukos case, the decision of the Hulley tribunal on contributory fault invites three observations of a more general nature concerning distinct aspects of applicability of that concept in investment treaty disputes. These issues relate to: (1) the problem of attribution of conduct to investors, (2) weaknesses of the approach to the assessment of contributory fault as a percentage of the overall damage, and (3) the requirements of contributory fault in cases involving indirect expropriation. Admittedly, the Annulment Committee held in MTD that “Part II of the ILC Articles, in which Article 39 is located, is concerned with claims between States, though it includes claims brought on behalf of individuals, e.g., within the framework of diplomatic protection. There is no reason not to apply the same principle of contribution to claims for breach of treaty brought by individuals [footnote omitted].” However, this section shall explain why certain qualifications may be necessary to such approach.

4.1. Attribution of Conduct

The concept of attribution is most widely discussed as one of the two key requirements for international responsibility of States. However, similar questions arise at the time of analysis of a conduct that gives rise to the contributory fault of an investor. Throughout this paper, the notion of the “injured party” was used to define a person responsible for the blameable conduct. However, this is an oversimplification and an intellectual shortcut applied solely for reasons of clarity of the analysis. In fact, the problem of attribution of blameable conduct remains to a large extent unaddressed and unresolved.

Article 39 ARSIWA refers to the conduct of the injured state or any person or entity in relation to whom reparation is sought. Clearly, the provision was drafted with a view to inter-state disputes and cannot be applied wholesale in the investor-state context, where no “injured state” appears. The Hulley case is useful as it casts light on the complexity of the problem. Notably, the incriminated conduct took place at the company level (Yukos), whereas the consequences of the contributory fault were borne by the claimants and shareholders in that company. The tribunal did not explain the basis of its legal theory on which it attributed the conduct of Yukos, a Russian company, to its shareholders, which were Cypriot and UK companies with separate legal personalities. The tribunal contained itself to a single remark which suggests that the mere fact of control of Yukos by the claimants was

88 MTD Equity Sdn Bhd. v. The Republic of Chile, ICSID Case No. ARB/01/7, Decision on Annulment, 21 March 2007, para. 99.

89 Article 2(a) ARSIWA.
sufficient.\textsuperscript{90} This observation, however, is not fully consistent with the jurisdictional decision in \textit{Hulley}, which hinges upon the concept of the separate corporate personalities of the claimants.\textsuperscript{91}

The approach of the \textit{Hulley} tribunal in that respect is not unique. The problem is largely unexplored and raises questions of a general nature, exceeding the particularities of Yukos. Does Article 39 ARSIWA allow for attribution of culpable conduct of third parties to the investor, and under which circumstances? Is the test of control alluded to by the \textit{Hulley} tribunal sufficient? Should it be the case, would that imply that the conduct of the Yukos managers could not be attributed to the minority shareholder of Yukos, or holders of the depository receipts who exercised no effective control over the company? Assuming that Hulley, Veteran and Yukos Universal Limited were each minority shareholders of Yukos, and formally claimants in separate proceedings, how did the \textit{Hulley} tribunal establish the control criterion? Did each of the claimants control Yukos in the same way? Would it be relevant for the question of attribution of blameable conduct that a certain investor, such as \textit{RosInvestCo}, purchased the shares in Yukos at a certain moment when the blameable conduct had already taken place? Would an investor be able to protect itself against the consequences of contributory fault by showing that it acted with due diligence in both the appointment of the local management and supervision of its activities? Needless to say, these questions are of significant practical importance in a world full of complex corporate structures and treaty claims filed by indirect or minority shareholders.

Following \textit{Hulley}, these questions come into the spotlight but remain unsolved at a general conceptual level. They also exceed the scope of this paper. To a certain extent, they remain factspecific questions and may call for an overall assessment of a given case. The language of Article 39 ARSIWA is broad enough to accommodate a view that the conduct of the officers of a company, the shares of which constitute an investment of another company, can be attributed to the latter company. The concept of “\textit{any person or entity in relation to whom reparation is sought}” is sufficiently broad to include also the companies remaining both under, and out of the control of the investor (hence including also minority shareholders), provided the damages are sought in relation to an investment in that company. Moreover, the jurisprudence of arbitral tribunals shows that investors can suffer negative consequences of blameable conduct of the local managers or their business partners, even though no wrongful conduct is imputed to the investors personally.\textsuperscript{92} The predominant approach seems

\textsuperscript{90} \textit{Hulley}, para. 1599.

\textsuperscript{91} \textit{Hulley Enterprises Limited (Cyprus) v. The Russian Federation}, UNCITRAL, PCA Case No. AA 226, Interim Award on Jurisdiction and Admissibility of 30 November 2009, paras. 411 to 417.

\textsuperscript{92} See e.g. \textit{Robert Azinian, Kenneth Davitian, & Ellen Baca v. The United Mexican States}, ICSID Case No. ARB (AF)/97/2, Award of 1 November 1999 paras. 122-123; \textit{Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania}, ICSID Case No. ARB/05/22, Award of 24 June 2008, para. 789.
to accept that the investor and the entire structure in which it operates represents a monolith for purposes of attribution of fault, largely in the same way in which the state is seen as one unit for purposes of establishment of international responsibility. This approach is certainly efficient from the procedural point of view, as it precludes possible battles over evidence related to the state of consciousness of particular individuals. It can also be considered as fair and even-handed, especially in light of the similar treatment of the state as one entity. However, the practical consequences of this fact for the investors should not be underestimated. Moreover, no matter how pragmatic and equitable this concept may be, it lacks an adequate legal theory explaining it.

4.2. Weaknesses of the Discretionary Estimates of Contributory Fault

The Hulley tribunal’s decision on contributory fault may well flow from a desire to react in a balanced way to the perceived mutual transgressions of both parties. The 75-25 % split adopted by the tribunal seems to represent the degree to which the Tribunal apportioned the fault among them. However, a “Gordian-knot” approach to arrive at a decision which would otherwise require a careful determination of multiple interacting factors may lead to unintended consequences. The preceding section of this paper shows, for example, that the financial consequences of the 75-25 % split are in high probability much more adverse for the claimants than the situation in which they would have been had Russia levied all the re-assessed taxes from Yukos (with the exclusion of VAT and fines). Accordingly, an unintended consequence of the determination of the Hulley tribunal may be the partial perpetuation of the effects of the expropriatory conduct of Russia.

A similar criticism can be extended to the Occidental award from 2012, in which a largely similar approach to the assessment of consequences of contributory fault of the investor was adopted. The Occidental tribunal determined that the investors were expropriated by the act of termination of the concession agreement. That termination was officially declared to be caused by a number of alleged infractions committed by the investor, including the failure to obtain the state’s consent for the transfer of a part of rights and obligations under the concession agreement. One of the key issues in the ensuing arbitration was whether the transaction between the claimant and the other party actually amounted to a transfer of rights, for which an approval needed to be sought. The tribunal ultimately reached the conclusion that it did, and it criticized ex post the investor for its choice not to seek consent for that transfer. The resulting conclusion was that Ecuador was entitled to react to the transgression on the part of the investor, and the termination of the concession agreement was one of the sanctions expressly provided in the applicable Ecuadorian law. The tribunal found, however, that the choice of that particular sanction was disproportionate in the circumstances of the case and that Ecuador could have resorted to a more proportionate sanction. The failure to act proportionately was found by the tribunal to be the reason why the termination of the concession agreement was declared to be an act of unlawful expropriation. However, the tribunal found that the investor’s decision not to seek consent for the transfer of rights, contributed to the injury. Accordingly, the amount of damages
was reduced by 25 %, which equalled USD 590 million. The paradox between the tribunal’s ruling on
the liability of Ecuador and the ruling on the contributory fault of the investor consists in that the
tribunal criticised Ecuador for terminating the concession agreement in lieu of imposing a
“proportionate” sanction, such as the “insistence on payment of a transfer fee in the order of USD 11.8
million”93. At the same time, the tribunal itself endorsed the effects of expropriation of USD 590
million as a sanction for the same transgression, notably by reducing the damages awarded to the
claimants based on the contributory fault. It is not clear how (1) levying a fee of USD 11.8 million and
(2) reduction of damages by USD 590 million can both be consistent with international law as
legitimate responses to the same arguably blameable conduct of the investor. They are clearly not
equivalent. It should further be noted that one of the arbitrators in the Occidental case proposed a more
extensive allocation of the contributory fault to the investor, at the level of 50 % (or 1.2 billion USD).
This further magnifies the problem under analysis.

These observations plausibly demonstrate the weaknesses of the approach to the estimation of
contributory fault by way of proportional reduction of damages by a given percentage. Admittedly, the
Hulley and Occidental tribunals, as well as the MTD Annulment Committee are correct in that
tribunals have a “corresponding margin of estimation”94 in determination of the consequences of the
contributory fault. This may be so, but a simple split expressed as a percentage more approximates to a
business deal or a decision taken ex aequo et bono rather than the outcome of a legal determination
made in accordance with transparent and predictable criteria. Accordingly, it is bound to raise
concerns among investors, states, third party funders, lending institutions, capital markets and legal
professionals, with respect to the predictability of the investment treaty arbitration process, especially
in financial terms. No modern, sophisticated business organization is prepared to work on the
assumption that its multi-million claim, meticulously calculated by dedicated quantum experts, could
be axed by an unknown percentage based on a non-transparent and unpredictable guess taken upon
unclear criteria.

The search for boundaries of the tribunals’ margin of estimation is further hindered by the fact
that to date only three tribunals applied the contributory fault doctrine in investment treaty disputes.
On the basis of this developing jurisprudence, one could argue that the contribution of the investor, in
order to be taken into account by the tribunal, needs to be “substantial” and “material”.95 In practical
terms, as applied by the MTD, Occidental and Hulley tribunals, the contributory fault of the investors
was set in the range between 25 % and 50 %. On this basis one could possibly argue that a

93 Occidental, para. 424.
94 MTD Equity Sdn Bhd. v. The Republic of Chile, ICSID Case No. ARB/01/7, Decision on Annulment, 21
95 Hulley, para. 1600.
contribution that does not achieve the 25 % level is either insignificant or immaterial. However, such proposition may be defied on the basis of the *Hulley* awards alone, as it can be shown that the actual quantitative implications of the investor’s contribution to the injury (i.e. corresponding to the hypothetical lawful tax assessments) were much lower than the USD 16.7 billion, i.e. 25 % of the injury as determined by the tribunal. It is argued in this paper that if the *Hulley* tribunal had simulated the hypothetical implications of the tax abuse of Yukos in the event of an internationally lawful response by Russia, it may have arrived at a conclusion that the actual level of that contribution should be set at a level not exceeding 6 % of the fair market value of Yukos as determined by the tribunal in the award. This would hardly qualify as a material and substantial contribution.

At the same time, it should also possible to argue that if the contribution of the investor was to be set at a level exceeding 50 %, this would imply that the conduct of the investor had been the main reason for the injury. This in turn would give rise to doubts whether, under the facts of a particular case, the state should bear any international responsibility for its acts, or whether it would rather be appropriate to let the investor bear the consequences of the self-inflicted loss. As a matter of fact, no investment treaty decision that has applied the contributory fault doctrine to date has accepted the level of investor’s contribution beyond the 50 % level. However, there are no established rules that would prevent an investment treaty tribunal from accepting the level of contributory fault of an investor either below the threshold of 25 %, or above the level of 50 %. Indeed, the jurisprudence of international tribunals includes cases in which the responsible state was ordered to pay reparations corresponding to less than 50 % of the injury, if that was justified by the extent to which it had caused that damage.96

The key issue, moreover, is how the tribunals agree on a given percentage as that corresponding to the investor’s contribution to injury. It seems there is no other yardstick than the arbitrators’ internal conviction of what is just and equitable in the given circumstances. However, this will usually vary depending on the composition of the particular tribunal, and is unpredictable. As the example of *Occidental* shows, there may be significant differences of view on this point among the members of the same tribunal. While two members of the *Occidental* tribunal believed it was appropriate to apportion the investors with the 25 % contribution share, the other arbitrator though it more appropriate to apply a 50-50 split. In the given case, that difference of 25 % translated into USD 590 million,97 and hinged upon the discretionary internal conviction of a single person on the panel. In the *Hulley* awards, there is not a word of explanation why the tribunal thought that the 25 % share of

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96 See C. Gray, *Judicial Remedies in International Law*, Oxford 1987, p. 24; see case of *British Claims in Spanish Morocco (Spain v. United Kingdom)*, 2 RIAA, p. 615, at 655 *et seq* and the *Martini case* (damages corresponding to 1/3 of lost profits), 2 RIAA 975, at. 980.

97 *Occidental* award, paras. 824-825.
the claimants was more appropriate than e.g. 24 % or 30 %. Given the values involved in the *Hulley* case, each percentage point more or less implies a change of approximately USD 670 million in the amount awarded from Russia. This is more than the annual budget of certain developing states (e.g. Liberia - USD 559 million).

The approach based on allocation of responsibility in percentages has also other important drawbacks. Under this approach, the tribunals first determine the investor’s contribution as a percentage, and then multiply it by the amount of the compensable loss previously determined e.g. as a concept of sunk cost of the investment (*MTD*) or its fair market value (*Hulley* and *Occidental*). This implies, however, that the financial implications of the tribunal’s determination of contributory fault ultimately depends on the magnitude of the loss inflicted on the investors, which in turns depends on the size of the original investment. The actual impact of the blameable conduct of the investor on the magnitude of the injury which can be established in terms of the causal relationship, does not matter in that equation. Such result, it is submitted, is inconsistent with the theoretical construction of contributory fault, explained in the Overview, as well as with Articles 31(2), Article 34, Article 36(1) and 39 ARSIWA.

Moreover, the approach may be questionable from the point of equality of treatment, as it can discriminate larger investments against smaller ones. This can be shown at the example of two investors, equally treated with unlawful expropriations as a response to their blameable conduct, which are found to be responsible for contribution to their injury in 25 % each. Those investors would see their claims curtailed by different amounts, depending on the product of the amount of their actual damage and the factor of 0.25. The larger investment would be treated with a more severe sanction (in monetary terms), proportionately to its size. Since the causal influence of the blameable conduct on the specific injury would not matter, the ultimate effect would depend purely on the wealth of the perpetrator.

It results that in such situation contributory fault would cease to be an instrument ensuring that the state does not compensate the individual for the consequences of the blameable conduct of the latter. This approach would *de facto* turn contributory fault into a punitive sanction, applied to the investors on account of their blameable conduct, which would depend on two parameters only: (1) the magnitude of the loss caused by the internationally wrongful act of the state, and (2) a discretionary factor, established as a percentage by the arbitral tribunal according to its own internal conviction. This result is clearly unacceptable and, as shown in the Overview of this paper, inconsistent with the purpose of the law of international responsibility. Also, if such sanctions grow in proportion to the value of the investment, it is questionable if they can be regarded as the most appropriate instrument to foster the objectives of treaties concerned with the promotion and protection of foreign investment.

The foregoing observations lead to a more far-reaching proposition. The contributory fault should not serve in investment treaty arbitration as a rule of equity available to the tribunals when they intend to do justice and prosecute the investors for breaches of domestic law. It should be borne in mind that there is an inherent asymmetry between the positions of investors and states. Host states have a variety of measures at their disposal, in accordance with their own internal legal systems, to combat the unlawful or abusive conduct of an investor. Contrary to the states, which dispose of this variety of measures, many of which can be applied unilaterally by the states by way of a decree or a decision of the executive branch of the Government, investors do not have adequate means of protection. Investment treaty arbitration was created precisely as a remedy for that perceived lack of equilibrium. Using contributory fault as another punitive sanction against investors is therefore not necessary.

Moreover, in the context of claims of indirect expropriations, it is pertinent to observe that disproportionate reductions of damages that are not linked with the actual extent of the impact of the blameable conduct on the injury, have the de facto effect of partial endorsement and perpetuation of the unlawful act of expropriation. The result is clearly paradoxical, since it implies that a tribunal first openly condemns the expropriation as an internationally unlawful act of the state, and then tacitly approves its effects by refusing to order the state to compensate the injury caused by that act. This also raises concerns of unjust enrichment of states. It is submitted that these very side-effects of the excessive reduction of damages on account of contributory fault, are among the most important arguments supporting the view that the implications of contributory fault should be assessed principally on the plane of causality and the influence of the blameable conduct on the extent of injury.

The foregoing comments do not signify, however, that a discretionary split of responsibility between the state and the investor would never be justified. Indeed, there may well be situations in which the contributory effect of the investor’s conduct on the injury would be clear and material, although not easily quantifiable in monetary terms. Nevertheless, given the predominantly economic nature of investment treaty disputes, such situations would occur rather rarely. In most cases, including Hulley and Occidental, there would be some yardstick against which the effects of the blameable conduct of the investor could be measured.

99 To a certain extent, the MTD case was a good example of such situation. The injury of the investor was related to the amount of sunk costs the investor incurred in reliance of the expectation of the investment project moving forward. Chile was held liable for breach of the treaty essentially because it stimulated that reliance to a certain extent. However, while the reliance on the state representations would have justified certain expenditures, the investor was held by the tribunal to have put too much reliance on these statements and to enter into an unfavourable transaction. Since the injury was largely associated with that single transaction (purchase of real estate), there seem to have been no better approach than to share the responsibility between the investor and the state according to the 50/50 split.
Accordingly, the point this paper aims to make is that in investment treaty disputes, broad powers of the tribunal to determine the consequences of the contributory fault of the investor should not imply full discretion. Rather, that discretion is curtailed by the constitutive elements of contributory fault, including the requirement to quantify the actual contribution of the blameable conduct of the investor to the extent of its injury. A discretionary split of responsibility, measurable in percentage terms, should be the approach of last, rather than first resort. Before this approach is taken, tribunals should appreciate the entire evidence and look for possible anchors that could provide guidelines or benchmarks, against which the fairness of the tribunal’s intended decision on contributory fault could be tested and confirmed.

4.3. Contributory Fault and Indirect Expropriation

The final problem analysed in this paper concerns the peculiar relationship between the notion of indirect expropriation and the concept of contributory fault. As noted at the outset, blameable conduct of the injured party may be relevant first to the question whether the international responsibility of the state arises in first place. However, once this hurdle is overcome, blameable conduct becomes relevant only to the extent that it contributes to the extent of injury.

In its turn, the concept of indirect expropriation relates to a situation in which an investor, although preserves the legal title to the property, is effectively deprived of any meaningful benefit thereof, in particular because its economic value is permanently and entirely destroyed. The extent and character of the loss is therefore critically important, in particular to distinguish indirect expropriation from other, less intrusive breaches of an international investment treaty, such as the breach of the fair and equitable treatment standard.

This makes relevant the question about the reasons for the loss of value of the investment. The practical implications of this issue may be shown by way of an example where the indirect expropriation results from the bankruptcy of a company in the host state. It could be assumed that the “but for” test demonstrates with probability that the bankruptcy of the company was caused by the combination of two major factors, i.e. negligent conduct of the investor and a discriminatory measure taken by the state. The test also shows that the company would have remained on the market in the absence of either of the two factors. In such case, the blameable conduct of the investor not only contributes to the injury - it also contributes to the existence of the internationally wrongful act that would not have occurred but for the blameable conduct of the investor. Admittedly, the absence of bankruptcy would not entirely remove the problem of international responsibility of the state for the breach of the fair and equitable treatment standard, or another obligation under an investment protection treaty. It may occur, however, that the particular treaty curtails the scope of the ISDS clause only to disputes resulting from expropriation. The dilemma may then be the following: is this situation an act of expropriation, giving the investor both a jurisdictional standing and claim for damages which
makes immune the investor from the effects of its blameable conduct? Or should it not be seen as an act of expropriation, with the resulting effect of impunity of the state for its internationally wrongful conduct? The answer may be fact-specific, as it could result that the bankruptcy of the company has one or more predominant causes clearly related to one party more than the other. Accordingly, it would not be fair to order the state to return the value of the entire investment in the situation where its measures were the proverbial last straw breaking the back of the investment that was already collapsing under the imprudent management of its owners. Likewise, some blameable conduct of an investor should not be sufficient to hold the state immune if its measures were the main reason for the company’s bankruptcy.

4. Conclusions

Contributory fault plays a necessary role in the law of international responsibility. It should prevent the investors from being rewarded for their blameable conduct. It should also ensure that the state responsible for an internationally wrongful act is ordered to make nothing less, and nothing more, than the full reparation of the injury caused by that act. Accordingly, contributory fault is not a rule of equity which empowers the tribunal to apply its own sense of justice and to mollify the results which deem excessively harsh to the host state.

As a legally defined concept, contributory fault is governed by its own rules. It requires an examination of the actual effect of the blameable conduct of the investor on the amount of its injury. Such examination should take into account all facts of the case and purport to establish the correct value with reference to the available anchors, such as the value of the right or claim to which the blameable conduct refers. Although the arbitrators are ultimately empowered to make a free determination of responsibility, they should not use that right lightly, so as not to undercompensate the investor and hence not to perpetuate the effects of the internationally unlawful act.

The decision on contributory fault in Hulley may be seen as a good faith attempt to do justice and strike a balance between conflicting values. However, the decision displays important weaknesses and may give rise in the future to a new wave of defences against investment treaty claims.

It is submitted that a better approach for the tribunal would be not to apply contributory fault at all, and instead to reduce the damages due to claimants by the amounts representing the actual value of Russia’s legitimate tax claims and related costs.

This notwithstanding, the decision highlights a series of issues relating to contributory fault and may significantly contribute to the development of this concept in the law of investment treaty disputes.