BETWEEN A ROCK AND A HARD PLACE: CLAIMS AGAINST RUSSIA IN INVESTMENT TREATY ARBITRATION - PART II OF II

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As discussed in Part I of this two-part series, Russia has imposed sweeping economic measures in response to the international sanctions imposed by other States on Russia for its invasion of Ukraine. Those economic measures impact a wide variety of market sectors and foreign investors from around the world. Importantly, however, a significant body of international investment agreements currently in force with Russia (such as bilateral investment treaties (or BITs) and free trade agreements with investment chapters) also provide substantive obligations for Russia to promote and protect foreign investment in its territory. Covered investors often have access to investment treaty arbitration against Russia in the event of breach of those obligations.

Below, we consider (1) a number of the economic measures imposed by Russia on foreign investors, (2) the landscape of bilateral investment treaties currently in force with Russia that provide protection for foreign investment, and (3) the potential to pursue investment treaty arbitration with Russia directly as a respondent State.

ECONOMIC MEASURES IMPOSED BY RUSSIA ON FOREIGN INVESTORS

The Russian response to the international sanctions imposed by a wide variety of States has taken the form of a series of economic measures imposed on foreign investment by decree. These measures reportedly include the following:

- *Currency Transfer Restrictions.* Temporary restrictions on Russian residents (1) providing foreign currency loans to non-residents, (2) crediting foreign currency to bank accounts outside of Russia, and (3) conducting money transfers using electronic instruments of payment provided by foreign payment service providers without opening a bank account.[1]
- *Transaction Approval Requirements.* New procedural requirements to obtain clearance from a Russian government commission for certain transactions between Russian residents and foreign persons connected to “unfriendly” foreign States (as discussed further below) or other persons under the control of such foreign persons, whether in relation to the provision of loans in rubles or to the creation of certain rights of ownership in securities or real estate for such foreign persons.[2]
- *Prohibition of Foreign Currency Export*. A prohibition on the export of cash or monetary instruments in foreign currency exceeding USD $10,000 in value.[3]

- *Restrictions on Debt Repayment.* A temporary debt payment procedure for the fulfilment of certain loan obligations to foreign creditors by the Russian Federation (or constituent entities or municipalities) and Russian residents by which foreign creditors associated with *"unfriendly"* foreign States may receive debt payments due from Russian residents via special so-called *"C-type"* accounts only in rubles at the official exchange rate to be set by the Russian Central Bank.[4]
- *Prohibition on Exports and Imports.* Measures which, *inter alia*, prohibit the export from or import into Russia of certain products or raw materials until 31 December 2022.[5]
- *Non-Enforcement of Intellectual Property Rights.* A significant change in the law providing that patent holders associated with "unfriendly" States (including citizens and registered entities of such States as well as entities with primary business activities in such States) will receive 0% of the actual proceeds from the use of their inventions, models or designs, including from the production and sale of goods.[6]

Other relevant measures have also been imposed by Russia on foreign investors, and at the time of this writing, there have been reports that the Russian government is considering nationalization of sectors or expropriation of foreign assets with negative implications for the value of investments of foreign investors associated with "unfriendly" States.[7] In particular, Russian lawmakers have reportedly *"proposed to transfer businesses of foreign companies that are leaving Russia to the [S]tate development bank VEB, giving the owners of such firms the option to resume their operations in Russia or sell businesses within three months".*[8] While details and implementation are subject to further development, a bill reportedly submitted in the lower house of the Russian parliament anticipates *"appointing VEB or other entities, as per authorities' and courts' decisions, as external administration at companies where foreign ownership exceeds 25%"*.[9] The Russian Central Bank has also been given authority to carry out key aspects of the measures, including in relation to the transfer of certain funds and the making of certain payments to foreign entities.[10]

To identify which States are categorized as "unfriendly", on 5 March 2022, Russia issued a list of "*foreign States and territories committing unfriendly actions"* as a result of such States' participation in one form or another of international sanctions imposed in response to Russian military action in Ukraine.

RUSSIA'S BILATERAL INVESTMENT TREATIES

While several types of international legal instruments (e.g., multilateral investment treaties such as the Energy Charter Treaty or even investment contracts directly with a State) may provide for investor-State arbitration, we turn now for illustration to the landscape of BITs currently in force with Russia and the potential for foreign investors affected by Russia's economic measures to pursue relief in investment treaty arbitration under those agreements.

There are reportedly 62 BITs currently in force with Russia.[11] The table below lists the State counterparties to those agreements. Those States now subject to Russia's economic measures appear in shaded boxes with bold text. Investors that are nationals of or entities incorporated in the States in the shaded boxes in the table below may be more likely to have claims in investment treaty arbitration arising from Russia's apparent breach of its obligations to promote and protect foreign investment.

STATES WITH BILATERAL INVESTMENT TREATIES CURRENTLY IN FORCE WITH RUSSIA (STATES TARGETED BY RUSSIAN ECONOMIC MEASURES APPEAR BELOW IN SHADED BOXES)			
Albania	Finland	Luxembourg	Sweden
Angola	France	Moldova	Switzerland
Argentina	Germany	Mongolia	Syria
Armenia	Greece	Netherlands	Turkey
Austria	Hungary	Nicaragua	Turkmenistan
Azerbaijan	Indonesia	North Korea	United Arab Emirates
Bahrain	Iran	North Macedonia	Ukraine
Bulgaria	Italy	Norway	United Kingdom
Cambodia	Japan	Palestine	Uzbekistan
Canada	Jordan	Qatar	Venezuela
China	Kazakhstan	Romania	Vietnam
Czech Republic (Czechia)	Kuwait	Singapore	Yemen
Cuba	Lebanon	Slovakia	Yugoslavia (former)
Denmark	Laos	South Africa	Zimbabwe
Egypt	Libya	South Korea	
Equatorial Guinea	Lithuania	Spain	

While every investment treaty must be evaluated on its own terms, there are certain broad characteristics present in many of Russia's BITs, including an inclusive scope of coverage for foreign investors and investments as well as generally broad standards of protection.

In general, any natural or legal person of a signatory State will be a covered investor as defined in the relevant BIT. Many investment treaties also feature a broadly defined scope of the term “investment” (often covering “all assets”) so that investment treaty protection may be available to covered foreign investors regardless of the particular type of investment lost or reduced in value as a result of Russian economic measures.

Common investment protection standards available under Russia's BITs include, among others:

- *No Unlawful Expropriation*

    - Future claims may relate to any uncompensated direct or indirect taking of foreign investors' assets, whether by nationalization or other total devaluation of such assets; one example may prove to be foreign aviation assets reportedly valued in excess of USD $12 billion that foreign investors have been prevented from removing from Russia to date.[12]
- *Fair & Equitable Treatment*
    - Future claims may relate to the loss or devaluation of equity investments that foreign investors have been forestalled or prevented from divesting by Russian economic measures, particularly where the result is a significant devaluation of the investment against the legitimate expectations of such investors.
- *Most-Favoured Nation*
    - Future claims may relate to discriminatory Russian economic measures that disadvantage investors in joint ventures operating in Russia (e.g., in the electronic manufacturing or energy sectors) as compared to Russia's treatment of other foreign investors in comparable circumstances.
- *National Treatment*
    - Future claims may relate to losses suffered by foreign patent holders affected by the recent changes to intellectual property protection laws in Russia where preferential patent protection is offered instead to Russian nationals.
- *Free Transfer of Payments*
    - Future claims may relate to losses suffered by foreign investors as a result of interference of the Russian government with commercial relationships involving currency transfers or payments under contracts with Russian counterparties (e.g., exporters or importers).

The examples above are illustrative only, and many other investment scenarios could be provided. Also, depending on the specific government measure, more than one of the above investment protection standards may be breached simultaneously.

INVESTMENT TREATY ARBITRATION WITH RUSSIA

Covered investors may generally commence investment treaty arbitration against Russia in the method prescribed in the relevant legal instrument (such as one of the BITs described above). This may require pre-arbitral notification and a mandatory negotiation or "cooling off" period prior to the commencement of arbitration (often six months), which may then proceed, for example, with the filing of a notice of arbitration and the constitution of an arbitral tribunal under the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL). Of course, a range of factors from legal to commercial considerations should be addressed prior to taking such action in order to determine whether investment treaty arbitration is available and whether it is the best course of action for a particular investor in a given case. A successful claim can result in an award of damages issued by such an independent arbitral tribunal in favour of an affected investor, and many arbitral awards against Russia may be enforced under the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958) (i.e., the New York Convention).[13] Such enforcement would likely proceed in the courts of one or more of the 169 New York Convention Member States against certain assets of the Russian government that may be present outside of Russia.

One practical question that will be important for investors to consider is whether sufficient assets of the Russian government may be available in other jurisdictions to allow for enforcement following the obtainment of a favourable arbitral award. Of course, only time will tell what diplomatic resolution may arise from the current conflict and whether and how Russian government funds may be applied to address the critical humanitarian crisis and post-conflict recovery of Ukraine, both of which are concerns requiring focus and attention as matters of urgent priority. In this regard, it is of note that over USD $280 billion in assets of the Russian Central Bank have reportedly been frozen in the territory of seven (7) Member States of the New York Convention (i.e., Austria, Canada, France, Germany, Japan, the United Kingdom, and the United States).[14] Given the current sanctions climate, it remains an open question whether it may ultimately prove possible that Russian assets frozen at present could be used in part to satisfy arbitral awards obtained by foreign investors affected by Russia's economic measures. Frozen Russian assets may prove to be a point of interest in the future enforcement of arbitral awards, especially if such assets may come to be characterized as commercial in nature or otherwise not subject to protection under the applicable domestic law on sovereign immunity in the jurisdiction on enforcement.

CONCLUSION: WHAT THIS MEANS FOR YOUR INVESTMENT

In the current geopolitical context, many foreign investors are caught between the proverbial “rock and a hard place” as their investments in Russia are negatively impacted by both international sanctions (including U.S., EU and UK sanctions) and Russia's own economic measures taken in response. Protecting foreign investment in Russia is likely to be a challenging exercise for the foreseeable future. It is also important, however, for investors to take all prudent steps to preserve information in connection with their investments in Russia urgently, considering carefully the potential of investment treaty arbitration to provide a future remedy in the event a covered investment is ultimately lost or devalued as a result of Russian economic measures.

While in some instances insurance may offer some potential means of obtaining compensation for losses, coverage may be limited and, given the level of exposure, insurers can be expected to seek to deny coverage, forcing policyholders to seek redress through litigation or arbitration.

In the end, seeking relief through investment treaty arbitration (with or without third-party litigation funding) may be an investor's only remaining option.

FOOTNOTES

[1] *See* Decree No. 79 of 28 February 2022 titled, “On the Application of Special Economic Measures in relation to Unfriendly Actions of the United States of America and Allied Foreign States and International Organizations” (“Decree No. 79”), Paragraph [3].

[2] *See* Decree No. 81 of 1 March 2022 titled, “On Additional temporary economic measures to ensure financial stability in Russia” (“Decree No. 81”), Paragraph [1].

[3] *Ibid.*

[4] *See* Decree No. 95 of 5 March 2022 titled, "On the temporary procedure for fulfilling obligations to certain foreign creditors" ("Decree No. 95"), Paragraphs [1] - [3].

[5] *See* Decree No. 100 of 8 March 2022 titled, "On the application of special economic measures in the field of foreign economic activity in order to ensure the security of the Russian Federation" ("Decree No. 100"), Paragraph [1].

[6] *See* Decree No. 299 of the Government of the Russian Federation dated 6 March 2022 titled, "On Amendments to Clause 2 of the Methodology for Determining the Amount of Compensation Paid to a Patent Owner When Deciding to Use an Invention, Utility Model or Industrial Design without His Consent, and the Procedure for Its Payment", available at http://publication.pravo.gov.ru/Document/View/0001202203070005.

[7] *Russia moves towards nationalising assets of firms that leave - ruling party*, Reuters.com (9 March 2022), available at https://www.reuters.com/business/russia-approves-first-step-towards-nationalising-assets-firms-that-leave-ruling-2022-03-09/.

[8] *Russian lawmakers propose giving VEB control in firms that leave Russia*, REUTERS.COM (13 April 2022), available at https://www.reuters.com/article/ukraine-crisis-russia-control/russian-lawmakers-propose-giving-veb-control-in-firms-that-leave-russia-idUSL2N2WA1F1.

[9] *Ibid.*

[10] *See* Decree No. 126 of 18 March 2022 titled, "On additional temporary economic measures to ensure the financial stability of the Russian Federation in the field of currency regulation" ("Decree No. 126"), Paragraphs [1] - [2].

[11] *International Investment Agreements Navigator: Russian Federation*, UNCTAD.org, available at https://investmentpolicy.unctad.org/international-investment-agreements/countries/175/russian-federation.

[12] *See, e.g., Hundreds of Planes Are Stranded in Russia. They May Never Be Recovered.*, The New York Times (12 March 2022), available at https://www.nytimes.com/2022/03/12/business/russia-airlines-planes.html.

[13] The USSR ratified the New York Convention in 1960, and the Russian Federation, as a successor of the USSR, continues to be a Contracting State. By contrast, Russia has not ratified the *Convention on the Settlement of Investment Disputes between States and Nationals of Other States* (1965) (the "ICSID Convention").

[14] *Graphic: Russia stored large amounts of money with many countries.* Hundreds of billions of it are now frozen., NBCNews.com (18 March 2022), available at https://www.nbcnews.com/data-graphics/russian-bank-foreign-reserve-billions-frozen-sanctions-n1292153.

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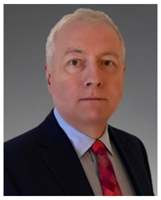

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