BCLP INTERNATIONAL ARBITRATION NEWSLETTER

INTERNATIONAL LAW RECOURSE FOR POTENTIAL EXPROPRIATION OF FOREIGN ASSETS BY RUSSIA

May 2022

bclplaw.com

BRYAN CAVE LEIGHTON PAISNER BCLP

INTRODUCTION

With the continuing exit and suspension of operation of foreign entities in Russia,[1] Russian State authorities are exploring retaliatory measures, including a regime for the nationalisation and forced sale of foreign assets.

It is a sovereign right of any State to seek to promulgate laws and introduce measures that would lead to the nationalisation, seizure or forced sale of privately owned assets. However, international law recognises such actions as expropriations and requires fair market value compensation by the State.[2] Should Russia implement the proposed regime or similar expropriatory measures, foreign entities may have recourse against Russia for fair market value compensation. Such recourse under international law is commonly pursued under an investment treaty between the State of the foreign entity and the expropriating State (in this case, Russia) (a bilateral investment treaty, "**BIT**"). Most of these BITs provide for an investor-State dispute settlement mechanism commonly referred to as investment treaty arbitration.

This note provides an overview of the proposed regime in Russia and introduces investment treaty arbitration, which may be available to foreign entities with respect to the proposed regime or other expropriatory measures by Russia.

THE PROPOSED REGIME IN RUSSIA

One of the latest potential retaliatory measures announced by the Russian authorities is the implementation of a regime for the nationalisation and forced sale of assets of foreign entities that have curtailed or suspended their operations in Russia.[3] This regime achieves the nationalisation and forced sale of assets through the appointment of external administration of companies owned by foreign entities. The external administrator appointed, which most likely will be a Russian State entity, may further decide to liquidate the company, which would result in a special public auction of the company's assets.

Essentially, the proposed regime would allow the Russian government to: (a) take control over Russian assets of foreign companies that have recently made a decision to leave Russia; and (b) transfer such Russian assets by way of a public auction to a Russian State entity, a third party or directly to the Russian government at a price to be set by the Russian Ministry of Economic Development. The fact that the ultimate owner of the seized Russian assets may not be affiliated with the Russian State would not change the fact that Russia's actions under the proposed regime would likely be expropriatory in nature.

Appointment of External Administration

According to the latest draft bill, the proposed regime would provide Russian courts[4] with the power to appoint external administration of companies that satisfy the following criteria:[5]

→ Foreign entities (companies or individuals) from "unfriendly" States own more than 25% of the shares of the company directly or indirectly. These "unfriendly" States are those listed in a regulation introduced by the Russian government on 5 March 2022,[6] and include the United States, the United Kingdom, all of the EU member States, Canada, Australia, Japan and South Korea. A full list of these "unfriendly" States is set out at Annex A to this note.

---

1 According to the Chief Executive Leadership Institute of the Yale School of Management, over 750 foreign companies have announced suspension, or complete or partial curtailment of their businesses in Russia since the commencement of the Russian invasion of Ukraine on 24 February 2022. See https://som.yale.edu/story/2022/over-750-companies-have-curtailed-operations-russia-some-remain (assessed on 22 April 2022).

2 This may be different if a business is already insolvent, as happened in the UK when the government had to place Railtrack plc in administration in October 2001. However, the proposed regime here would likely result in the nationalisation of businesses that are potentially successful and profitable, and not insolvent.

3 On 12 April 2022, a draft legislative bill No 104796-8 was introduced in the lower chamber of the Russian Parliament, the State Duma, entitled "On external administration for management of a company". The text of the draft bill is published at https://sozd.duma.gov.ru/bill/104796-8#bh_histras.

4 The relevant court is envisaged to be the Arbitrazh Court of the City of Moscow. See Article 3(1) of the draft bill.

5 See Article 1(3) of the draft bill.

6 Regulation of the Russian government No 430-p dated 5 March 2022.

- The company is essential for ensuring the stability of the Russian economy, and for protecting the rights and legitimate interests of citizens in Russia. For example, a company may be considered essential if it is the only manufacturer, supplier or provider of a particular product or service in Russia, or if it employs a significant proportion of the workforce in a particular location.[7]

This power of the Russian courts would be exercisable upon application by the Russian Federal Tax Service ("**FTS**"), following a process which would involve the consideration of proposals for external administration by a commission under the Russian Ministry of Economic Development.[8] The Russian courts may also order interim measures preventing the withdrawal of assets of the company out of Russia as it considers an application.

As currently proposed, there are a number of grounds upon which the Russian courts may exercise this power to appoint external administration with respect to companies that satisfy the abovementioned criteria. These grounds include situations where:[9]

- The management of the company has left or has been terminated contrary to Russian laws; or
- The curtailment or suspension of operation of the company would lead to an interruption of critical supply chains, increased consumer costs, significant job losses, etc.

The appointment of external administration may be for a period of up to 18 months (with the possibility of extension for another 18 months) and may be implemented in two ways:

- Placing the shares in the company in a trust controlled by the external administrator; or
- Transferring the management powers of the company to the external administrator.

The appointment of the external administrator may be terminated upon application by the current shareholders of the company owning more than 50% of the shares[10] or if the company goes into liquidation.

The Russian courts would decide on the appointment of external administration within six days of the acceptance of the application by FTS, and may appoint a Russian State entity, or other Russian entities, as the external administrator. This would effectively give the Russian government indirect control over assets and operations owned by foreign entities in Russia.

Nationalisation and Forced Sale of the Company Assets

The external administrator would be entitled to liquidate the company. If the external administrator decides to do so, the court would appoint it as the liquidator; and the external administrator as the liquidator would create a new company and transfer all assets of the original company to the new company.

The shares of this new company would then be put to a special public auction conducted in accordance with the provisions of Article 110 (4)-(2) of Russian Law No 127-FZ "On insolvency (bankruptcy)". The shareholders of the original company would not be able to participate at the public auction.[11] Further, the external administrator would have priority to purchase the shares of the new company.

If there are no bidders participating in the public auction, the Russian government may purchase the shares of the new company at a price set by the commission under the Russian Ministry of Economic Development.

The public auction proceeds would form part of the estate of the original company, and would be distributed to the original company's creditors in accordance with Russian insolvency laws. As the shareholders of the original company (e.g. the foreign company or individual whose assets have in effect been expropriated) have the lowest priority in terms of distribution of the company's estate, they would likely receive nothing from the auction proceeds. In any case, the current draft bill for the proposed regime does not envisage any payment of compensation to foreign entities following the forced sale of their assets.

---

7 See Article 1(6) of the draft bill.

8 This process would be initiated by the head of a sectoral federal executive body or the head of the region of the Russian Federation in which the company or its branch is present or is operating.

9 A full list of applicable grounds is set out in Article 1(8) of the draft bill.

10 This requires the shareholders to eliminate the circumstances which served as the basis for the appointment of external administration within 3 months from the date of appointment.

11 See Article 13(19) of the draft bill.

Current Status of the Proposed Regime

It remains to be seen how quickly the Russian legislature may pass the draft bill for the proposed regime.

According to a report that appeared in the Russian business daily, "Vedomosti", on 14 April 2022, the Russian legislative body, the State Duma, may consider the draft bill in May 2022. The report also quotes sources close to the administration of the Russian President that the current aim of the draft bill is to signal and warn foreign investors and their governments.

The information available on the State Duma website corroborates this report. According to the State Duma website, the draft bill is currently in the consultation stage of the legislative process until 11 May 2022 and it is part of a programme of legislative initiatives to be considered by the State Duma in May 2022.

The consideration and approval of the draft bill by the Russian legislature can be expedited.[12] By way of example, in 2020, Russian Federal Law No. 171-FZ of 8 June 2020, which introduced the possibility of transferring disputes involving sanctioned parties to the Russian courts despite existing foreign jurisdiction/arbitration agreements, was rushed through the Russian legislature within 12 days of its introduction.

POTENTIAL RECOURSE IN ARBITRATION UNDER INTERNATIONAL LAW

Domestically, under Russian law, foreign entities with assets in Russia will have little recourse once the Russian legislature promulgates the draft bill of the proposed regime and the Russian government implements the proposed regime. However, particular foreign entities may have recourse under international law against Russia for fair market value compensation with respect to assets, which would have been effectively taken away from the foreign entities under this proposed regime. This is because the proposed regime, or other similar measures, would likely constitute under international law expropriations of assets, both directly and indirectly by Russia, without compensation.

Given that Russia is party to a number of BITs with what it now classifies as "unfriendly" States, the implementation of the proposed regime or any other expropriatory measures will likely lead to a number of investment treaty arbitrations.

Expropriation and Investment Treaty Arbitration

Under international law, States (including Russia) are generally entitled to promulgate laws and/or implement measures that would nationalise, seize, interfere with or, to put it simply, take away the use and benefit of foreign entities' assets. Such actions are considered as expropriations under international law.

Expropriation is not illegal per se.[13] However, it is well recognised that foreign entities, whose assets have been expropriated, are entitled to fair market value compensation from States. Under modern international law practices, private foreign entities would enforce their entitlement to compensation under BITs between their home State and the State which expropriated their assets, in arbitration.

Such arbitration is known as investment treaty arbitration. Traditionally under customary international law, such direct enforcement of rights is not available to private individuals or companies. However, since the middle of the 20th century, as part of the globalisation of trade and investment, States began entering into BITs, which codify and supplement obligations owed by host States to foreign private investors under international law, and provide such foreign private investors with a mechanism to enforce those obligations directly against host States.

In addition to obligations with respect to expropriation, these BITs also codify and supplement the customary international law obligations for host States to treat assets of foreign private investors fairly and equitably, to provide security and protection and to permit the transfer of funds in and out of the host

[12] However, the fact that the draft bill was introduced by four individual members of the State Duma and not the Russian government indicates that the legislative process for the draft bill may not be expedited.

[13] The precise scope of lawful expropriation and the sort of actions an expropriating State is required to take with respect to expropriation will depend on the commitments that State had undertaken under international law, in particular under relevant investment or trade treaties.

States. These obligations may also be applicable with respect to the proposed regime and/or other measures implemented by Russia that target the assets of foreign entities.

Usually, the investor-State dispute settlement mechanisms under these BITs provide for resolution of disputes either in the domestic courts of the host State, and/or in arbitration. These mechanisms would also provide for what are known as "cooling-off periods" where advance notice of dispute is required before foreign private investors could commence any court or arbitral proceedings under the BITs. In most circumstances, domestic courts of a host State are unlikely to be and would not be seen as neutral and independent forums for the resolution of disputes under the relevant BIT. Therefore, foreign private investors would usually seek to enforce their rights under BITs by way of investment treaty arbitration.

Russia's Investment Treaties

Russia is party to a number of BITs which provide foreign private investors a right to pursue their entitlement under international law by way of investment treaty arbitration. Russia, or more precisely, the Russian Federation, declared itself as the "continuator" State of the former Soviet Union and treaties entered into by the Soviet Union bind Russia.

There are currently 27 BITs in force between Russia and States which Russia classifies as "unfriendly", including the United Kingdom, France, Germany, Canada, Japan and South Korea.[14] There is no BIT in force between the United States and Russia.

For foreign investors whose home State does not have a BIT with Russia (such as investors from the United States), they may still be able to claim compensation against Russia in investment treaty arbitration. Such foreign investors may hold their Russian assets through a corporate structure involving shareholders or subsidiary companies incorporated in States with BITs with Russia. In such cases, the "claimant" would be the shareholder or the subsidiary who could invoke an applicable BIT. Russians BITs with States that have not been classified as "unfriendly" could therefore be relevant in a claim by foreign investors whose assets are affected by measures taken by Russia.

Most of the BITs binding Russia oblige Russia to compensate foreign investors in the event of expropriation of their assets, in addition to providing also for investment treaty arbitration under the arbitration rules set by the United Nations Commission on International Trade Law.

However, potential claimants under these investment treaties should note that some of these treaties describe narrowly the sorts of dispute that could be resolved by way of investment treaty arbitration.

For example, in the BIT between Russia and Spain, the provision of investment treaty arbitration is only expressed with respect to the "amount or form of payment" for expropriation.[15] Such restrictive drafting led to an issue in one of the infamous Yukos investment treaty arbitrations[16] as to whether the BIT in question entitled foreign investors to refer any disputes in respect of expropriation by Russia. Although the arbitral tribunal initially found in favour of the investors in the arbitration, its award was subsequently overturned by the Swedish Court of Appeal, whose ruling was confirmed by the Supreme Court. The Swedish Courts held that the provision of investment treaty arbitration in the BIT is narrowly worded, limiting it to disputes over the question of the amount or method of payment for compensation and did not permit the arbitral tribunal to consider whether

---

14 The "unfriendly" States with investment treaties with Russia include: Albania, Austria, Belgium, Bulgaria, Canada, the Czech Republic; Denmark, Finland, France, Germany, Greece, Hungary, Italy, Japan, Lithuania, Luxembourg, the Netherlands, North Macedonia, Norway, Romania, Singapore, Slovakia, South Korea, Spain, Switzerland, Ukraine; and the United Kingdom.
In addition to BITs, 35 of these "unfriendly" States are also party to the Energy Charter Treaty ("**ECT**"). Russia had signed the ECT but did not ratify it; and in 2009, Russia notified its intention not to be a party to the ECT. The application of the ECT to Russia is therefore controversial, and arguably, Russia owes no rights or obligations under the ECT. However, it should be noted that in the infamous Yukos v Russia arbitration, an arbitral tribunal found that it did have jurisdiction over the dispute under the ECT despite the lack of ratification by Russia. This finding is controversial and has been the subject of decade-long challenge process by Russia.

15 Similar language also appears in investment treaties between Russia and the Netherlands (Article 9.2), Germany (Article 10.2) and Belgium/Luxembourg (Article 10.2).

16 *Renta 4 S.V.S.A and others v. Russia* (SCC Case No. 24/2007).

Spanish investors' investments had been expropriated.

Similarly, in another case concerning the same issue with respect to the Russia – Belgium/Luxembourg BIT,[17] an arbitral tribunal found that the restrictive dispute resolution clause in the BIT, which is typical of early Soviet-era BITs, was not broad enough to encompass the claimants' claims for expropriation. In addition, the arbitral tribunal held that the foreign investors' indirect investment was not covered by the underlying BIT, because they invested in shares of Belgium-incorporated companies, which then subsequently made an investment in Russia.

Enforcement

It has to be said that the enforcement of any future arbitral award obtained by foreign investors against Russia or its State assets abroad would not be without difficulties, as the decade-long court battles in the US and in the Netherlands over the enforcement of rulings and award in the infamous Yukos arbitration shows.

Russia will likely rely upon State immunity with respect to any enforcement of awards against its State assets situated outside of Russia. However, depending on the jurisdiction, there will likely be exceptions to the application of State immunity. For example, in most common law jurisdictions, State assets can still be available for enforcement if, amongst other things, those assets are for commercial purposes.

Successful claimants in investment treaty arbitration against Russia may also look to enforce against Russian State assets that have been sanctioned and/or frozen as part of the international community's response to Russia's invasion of Ukraine. Subject to the evolving nature of sanctions against Russia, enforcement against such assets in some jurisdictions may be possible.

Further, Russia is not party to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, commonly known as the ICSID Convention or the Washington Convention. The Washington Convention is a specifically designed international framework for investment treaty arbitrations, and facilitates enforcement of awards.

Instead, foreign investors would have to conduct their investment treaty arbitrations against Russia under the general framework for international arbitrations as provided under the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, commonly known as the New York Convention. Unlike the Washington Convention, however, the New York Convention framework provides a limited set of grounds on which national courts may refuse enforcement of awards.

The New York Convention has over 165 member States, including Russia, and will facilitate the enforcement of arbitral awards in the national courts of Russia and other member States (though for obvious reasons, enforcement of such awards against Russia in Russia is unlikely to be advisable). Foreign investors could in theory target Russian State assets, including those sanctioned assets, situated in member States to the New York Convention, such as the United States, the United Kingdom, Switzerland and offshore jurisdictions.

---

17 *Vladimir Berschader & Moises Berschader V. Russia* (SCC Case No. 080/2004).

ANNEX A

List of Unfriendly States

Albania

Andorra

Australia

Canada

The European Union, including Austria, Belgium, Bulgaria, Croatia, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, and Sweden

Iceland

Japan

Liechtenstein

Micronesia

Monaco

Montenegro

New Zealand

North Macedonia

Norway

San Marino

Singapore

South Korea

Switzerland

Taiwan

Ukraine

United Kingdom, including Jersey, Anguilla, the British Virgin Islands, and Gibraltar

United States of America.

Getting in touch

When you need a practical legal solution for your next business opportunity or challenge, please get in touch.

London
Governor's House
5 Laurence Pountney Hill
London EC4R 0BR England

George Burn
Tel: +44 (0)20 3400 2615
george.burn@bclplaw.com

Nadia Hubbuck
Tel: +44 (0)20 3400 2687
Nadia.hubbuck@bclplaw.com

Kevin Cheung
Tel: +44 (0)20 3400 4844
kevin.cheung@bclplaw.com