CIS Arbitration Forum

Conference 'CIS-related Disputes: Treaties, Sanctions, Compliance and Enforcement'

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What makes CIS-related disputes different?

To start preparing my remarks I considered all the different ways that CIS-related disputes are different. For example, here are some of the issues I considered addressing:

- Issues of treaty succession. There questions about which CIS states have succeeded to which Soviet-era treaties. And, as you likely know, tribunals are not in agreement on this point.
- Linguistic Issues and treaty interpretation. We're likely all familiar with the varying interpretations of the fork in the road provision of the Turkey/Uzbekistan BIT.
- Issues relating to moral damages. When a tribunal finds no breach in relation to the invest*ment*, can mistreatment of the inves*tor* still lead to damages?
- Country risk premiums. Whether the prevalence of expropriation in the area can lead to a higher country risk premium.

But then many of these topics are not unique to the CIS, for example some Venezuelan cases raise similar country risk issues. Translation issues and grammatically incorrect treaty language occur all over the world. And moral damages have been discussed in cases involving African and South American claimants.

So, I wanted to take a more general approach, and talk about three broader themes that are, at least somewhat, unique to how business is done and how governmental systems are set up in the CIS region and how those three themes are at the root of many issues in CIS-related disputes.

1. Overlapping concentration of economic power, political power, and family ties

The first general theme is that economic power is often concentrated in the hands of a few key players, political power is often concentrated in the hands of a few key players, and not uncommonly there is overlap between those that hold economic and political power.

What do I mean by this?

Well, in many CIS countries there are powerful oligarchs who have fingers in almost every pie. Further, in many CIS states, business, politics, and family are highly connected. An investor often ends up dealing with a close relation or family member of an important political figure, and things can become complicated in several ways. First, oligarchs themselves often become claimants

when political relationships go south. Further, an investor with links to a suddenly unpopular political figure may find the road ahead not as smooth as before. And business deals can be tricky when your counterpart has political ties that may or may not be official. A few examples to clarify:

- For example, Ukrainian Oligarch Igor Kolomoisky is a frequent claimant in Investor-State cases. He and his beneficially owned entities have brought claims against his home state of Ukraine under the ECT, several claims against Russia for investments originally located in Ukraine, and most recently he has been threatening claims against the US. In 2016, while in the middle of pursuing a claim against Russia on behalf of a bank he owns, Ukraine nationalized the bank after a massive fraud scheme was uncovered. Now instead of acting as the Claimant in the case, Mr. Kolomoisky is a defendant in several lawsuits related to the matter. It remains to be seen how far this fraudulent behavior will impact the pending ISDS case, as well as his other cases against Russia.
- There's also the series of cases brought by the Hourani family. For those of you unfamiliar with these cases, the Houranis managed to build an enormous business empire in Kazakhstan that included everything from poultry farming to oil to pharmaceuticals. The Houranis had connections with then-President Nazarbayev's son-in law, who was related to their family through marriage. However, the Houranis claim that once the President and his Son-in-law had a falling out, their businesses were targeted. This dispute spawned multiple ISDS claims, with varying success.
- You may likewise remember the Stati family's allegations that President Nazarbayev started a harassment campaign against their Kazakhstani oil business as a favor to the then-President of Moldova. The Stati's also alleged that part of the harassment was pressure to sell their investment to a different Nazarbayev son-in-law.

2. Business on Paper vs. Business in Actuality

The second general theme I want to talk about is that there is often a delta between what an investment tribunal expects to see in terms of how business is done and the realities of doing business in the CIS world.

You see this in several ways.

For example, ownership of an asset is normally not a straightforward chain of legal title. Rather, many Claimants have only beneficial ownership over a claimed investment, and that beneficial ownership needs to be traced through multiple levels of holding companies, beneficial oral trusts, and proxy officers or directors.

Another example of business reality vs ideal is the difference between a State's regulatory scheme on paper and as applied. CIS States often have volumes of written rules and regulations for everything, layers of required federal, regional, and local governmental approvals from each

of a dozen different agencies. But, more often than not transactions go forward without following the same strict requirements, companies operate with only a percentage of the technically necessary government approvals, and regulators often do not dot every I and cross every T for years, until all of a sudden something catches their attention.

These differences between business and regulatory ideals and business and regulatory reality create all kinds of questions for tribunals. Some of the issues we see in the cases that stem from this general theme, as seen in the cases:

- Is compliance with every single law and regulation necessary to fall within a BIT's legality provision, or is there some sort of balancing test, as discussed in the *Kim v. Uzbekistan* case?
- Was the government agency acting outside of its statutory delegated authority when it transacted with Claimant, and if so does a "void *ab initio*" transaction fall outside the scope of the Treaty, as discussed in the *Fuchs* v. *Georgia* matter?
- Was a license transfer "voidable" but not yet invalid, and if so, how does that impact the scope of Respondent's consent to arbitration, as discussed in the *Liman Oil v Kazkhstan* case?
- When does non-compliance or an attempt to avoid compliance with a regulation constitute contributory fault on the part of the investor like in the *Yukos* cases?
- Can inconsistent application of a regulation evidence bad intent on the part of the State and defeat a police powers defense, as in *Belokon*?

3. Corruption allegations are more common than elsewhere

In my view it is the combination of these first two themes--the overlap of economic and political circles and the disconnect between the regulatory and business environment on paper and how business is actually done—that is the reason corruption allegations are so easily raised in CIS cases. I think it might be fair to say that a Respondent state is more likely than not to bring a preliminary objection on the grounds of corruption.

- For example, it's fairly common for services contracts in the CIS area to be pretty vague about the types of services being provided. It's also pretty common for sales contracts to stipulate that the purchase price should be paid to some off-shore entity rather than the actual seller of the property. But does a vague consulting agreement necessarily mean that the deal was corrupt? What additional information is needed? This issue that has different resolutions in the *Metaltech* and *Kim* cases, both against Uzbekistan. In *Metaltech* the tribunal found the consultant payments were indicia of corruption, in *Kim* the tribunal found that the consultant payments were a legitimate finder's fee to the businessman who introduced the Claimant to the sale opportunity.

- Similarly, as I mentioned sometimes the amount paid is different than the amount officially charged. When a government official requests payment in for an amount higher than the one specified in the applicable statutory scheme, is that legitimate deviation from the regulation or an attempt to solicit a bribe? And even if the Respondent is soliciting a bribe, how much does the Claimant have to know about where the money is headed before it becomes actual corruption that deprives a tribunal of jurisdiction? In case this isn't obvious, I'm talking about the circumstances of *Stans Energy*, where the Tribunal found no corruption or bribery because the Claimants had no reason to believe the Minister's request was illegal, even though it appears that the Minister did end up diverting the funds elsewhere.
- Finally, as noted, many of an investor's business partners will be politically connected, even if they do not hold official political office. When the alleged bribe goes to someone who may or may not be a quasi government official, like the President's Daughter, What additional information is needed? On this point I wanted to mention the *Kim* case. In that case the Claimants were led to believe that they were purchasing cement plants from the daughter of then-President Karimov, although through a series of shell companies so that her name was never on any paperwork. Uzbekistan raised corruption objections, and as part of the analysis and the tribunal had to decide if Ms. Karimova was in fact a government official at the time of the sale. The Tribunal ultimately found that while at times Ms. Karimova had official roles in her father's government, there did not appear to be evidence that she had an official position at the time of the transaction in question.

4. Belief in unitary State actions against investors

The last general theme, and the one that has many many offshoots, is the fact that executive, legislative, law enforcement, and judicial organs of CIS governments are, rightly or wrongly, viewed as much more interconnected and influenced by each other than in other countries.

I think this belief in an interconnected, unitary government stems from the legacy of the one-party, Soviet behemoth and the continuing Soviet legal framework employed in varying degrees in all CIS States.

And we see this interplay among State organs throughout the allegations (sometimes found proven) in CIS Cases.

For example, creeping expropriation claims are very common against CIS States. Claimants in these cases often allege a multi-step expropriation through targeted, coordinated actions across various areas of the government.

For example, in the *Stati* case, the claimants accused Kazakhstan of routinely employing a 'playbook' to coerce foreign investors that started with 'an executive-mandated onslaught and

end[ed] with a firesale of assets to the State or an outright seizure.' The Stati claimants alleged a coordinated governmental effort against involving the financial police, the judicial system, and other state organs through 'harassing inspections, outrageous tax assessments, criminal prosecutions, fines. etc.'

Likewise, the claimants in the *Rumeli* case alleged that Kazakhstan had engaged in 'a series of acts which ... over a period of time culminate[d] in the expropriatory taking of [their] property.' The *Rumeli* claimants alleged that Kazakhstan's actions included termination of an investment contract, court decisions that resulted in new management of the joint venture they partially owned, physical ouster from the premises and exclusion from the management of their investment, and a culminating judicial decision that transferred claimants' shares to a third party and afforded minimal compensation.

There are a few elements about these creeping expropriation or coordinated State harassment claims that I wanted to touch on.

One, they often involve fines and tax assessments. However, as seen from the *Yukos* cases this can also raise questions of contributory fault if an investor has not been paying their taxes.

Two, they often involve criminal law. Claimants often allege that criminal prosecutions are brought as part of a campaign of harassment against an investor, and there have been several requests for preliminary measures filed by Claimants in efforts to stop allegedly harassing criminal investigations and prosecutions. For example, in the *Caratube* cases, the Hourani family twice sought preliminary measures ordering Kazakhstan to refrain from various criminal investigations and prosecutions, although both were denied.

Three, claims of improper criminal investigations and prosecutions often include suggestions, if not outright allegations, of improper collusion between the prosecutor and the courts.

Four, even if there is no criminal proceeding, a creeping expropriation claim against a CIS State frequently involves some type of civil court action, whether its invalidating a contract, upholding fines, or reallocating shares.

However, asking a BIT Tribunal to rule on the propriety of a domestic court's decision creates several problems from an international law perspective, and no clear consensus among tribunals. Tribunals are generally in agreement that they do have some ability to review domestic court decisions. And further they generally agree that not every procedural decision or potentially incorrect application of domestic law constitutes a breach of a BIT.

But beyond that, there is a lot of variation exactly what types of court actions can or even should be reviewed a second time by a BIT tribunal—is it only conduct that amounts to a denial of justice, only conduct that satisfies some kind of gross impropriety standard, only a court proceeding improperly instigated by another state organ or something else? One only need compare the

various reasonings from cases like *Sistem*, *Garanti Koza*, and *Rumeli* to see that tribunals are farm from uniform in their approach.

However, concerted regulatory expropriation claims have met with significant levels of success. The *Rumeli* tribunal found Kazakhstan liable for a '"creeping" expropriation' due to what the tribunal deemed improper collusion between Kazakhstan's State Investment Committee and the claimant's business partners, and 'which proceeded via a series of court decisions, culminating in the final decision of the Presidium of the Supreme Court.' While the *Stati* tribunal refused to find that Kazakhstan followed a 'playbook,' it did find that the actions alleged constituted a 'string of measures of coordinated harassment by various institutions of Respondent.'