LARGEST ARBITRAL AWARDS IN HISTORY ANNULLED AT THE SEAT

The Russian Federation v Veteran Petroleum Ltd, Yukos Universal Ltd and Hulley Enterprises Ltd(C/09/477160 / HA ZA 15-1, 15-2 and 15-122)

Introduction

By a decision handed down on 20 April 2016, the District Court in The Hague ("the District Court") set aside six arbitral awards which had been rendered by the Tribunal in the long-running and much-publicised dispute between the former majority shareholders of Yukos and Russia. The six awards, which were handed down on 18 July 2014, amounted to the largest known damages award in the history of arbitration – ordering Russia to pay US$50 billion for its unlawful expropriation of investments in Yukos. The underlying cases had been brought pursuant to the Energy Charter Treaty ("the ECT"), which had been signed by Russia but never ratified by the Russian Duma. It was this fact that led the District Court to conclude that the Tribunal had not had jurisdiction because Russia was not bound by the offer to arbitrate in Article 26 ECT. The provisional application of Article 26 ECT would have been contrary to Russian domestic law which does not recognise disputes of an essential public law character as being capable of settlement by arbitration.

Factual Background

Beginning in 2003 the Russian tax authorities suspected and accused Yukos, one of the world's largest companies which at one point accounted for about 20% of Russia's entire oil output, of massive tax evasion. In their efforts against Yukos, the Russian authorities imprisoned Yukos' owners, bankrupted Yukos and transferred its significant assets to Russia's state-owned companies, including Gazprom and Rosneft. In 2005, considering that they had not received sufficient or appropriate compensation for Russia's expropriation of their investments in Yukos, the former majority shareholders of Yukos commenced UNCITRAL arbitration proceedings in The Hague pursuant to the ECT.

By interim awards handed down in November 2009, the Tribunal (The Honourable L. Yves Fortier QC, Chairman; Dr. Charles Poncet; Judge Stephen M. Schwebel) took jurisdiction of the subject-matter of the disputes. As described above, the final awards were handed down on 18 July 2014.

Since then enforcement proceedings have been commenced and contested in multiple jurisdictions, including the USA, the UK and France. It has been reported that approximately €1 billion worth of Russian-owned assets in France has been frozen as a result of efforts to satisfy the awards.

Jurisdictional Objections before the Arbitral Tribunal

In November 2014, Russia filed applications to have the awards annulled through the Dutch courts. Russia renewed some of its jurisdictional objections that it had raised in the actual

arbitration proceedings, including those based on Articles 26 ECT (disputes between Contracting Party and an Investor are to be referred to arbitration) and Article 45(1) ECT (the ECT's signatories will provisionally apply the ECT's terms pending its entry into force to the extent that the provisional application does not contradict the signatory's own domestic constitution, laws or regulations). Russia signed the ECT in December 1994 but the treaty had never been ratified by the Russian Duma (Parliament).

The Tribunal had held that Article 26 ECT was provisionally applied in Russia by virtue of Article 45 ECT. The Tribunal took the view that Article 45(1) ECT required an "all or nothing" approach – i.e. the ECT's term regarding inconsistency with domestic law referred to the application of the entire ECT rather than specific parts. It was not suggested that Russian law did not allow for the provisional applications of international treaties generally, thus the entire ECT was provisionally applied in Russia including the arbitration obligation in Article 26 ECT.

Jurisdictional Objections before the District Court

However, the District Court in The Hague has now reached the opposite conclusion regarding provisional application. The District Court held that on a proper interpretation Article 45 ECT required a careful assessment of whether each individual article of the treaty was compatible or not with the domestic law of the signatory. Thus, the instant case turned on whether the subject-matter of the case was non-arbitrable under Russian domestic law.

Having taken expert evidence on Russian law, the District Court held that the position under Russian law was that disputes which were essentially of a public law nature were non-arbitrable. Since the instant case concerned disputes that arose out of a relationship between the Russian tax authorities and Yukos' former majority shareholders, this case fell into that non-arbitrable category of public law disputes.

The effect of this was that the provisional application of Article 26 ECT was incompatible with Russian domestic law, Russia was therefore not bound by an agreement to arbitrate, the Tribunal had erred in taking jurisdiction over the dispute, and the awards were set aside by the District Court.

Concluding Remarks

The former majority shareholders of Yukos have declared their intention to appeal against the judgment of the District Court. The case will now be heard by the Dutch Court of Appeal. There is a further appeal route to the Dutch Supreme Court.

As noted above, enforcement proceedings in multiple jurisdictions have been commenced. Such proceedings may now face something of a stumbling block in that Article V(1)(e) of the New York Convention provides that recognition and enforcement of an arbitral award may be refused where that award has been set aside by a court of competent authority in the country in which the award was made.

17th May 2016