KEY POINTS

- Some of the counter-sanctions currently in place could give rise to investment treaty claims by investors from "unfriendly states".
- After Russia's invasion of Crimea, dozens of investment treaty claims were commenced, mainly under the Ukraine-Russia Bilateral Investment Treaty (BIT).
- The Russian Federation is a country with assets abroad, including through state-owned and controlled companies, which are potentially available for investors to enforce against.

Spotlight

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Countering counter sanctions: treaty based remedies for investors in Russian assets?

In this Spotlight article the authors discuss examples of Russian counter-sanctions and when recourse by investors to protections conferred by investment treaties may be appropriate.

INTRODUCTION

War, according to Clausewitz, is the continuation of politics by other means. So too are economic sanctions. Originally an adjunct to warfare, in the form of blockades and prohibitions on trading with the enemy, sanctions are now viewed as an essential standalone tool of foreign policy, with the aim of using economic pressure to achieve political goals without resort to military action. But even though they do not involve the use of physical force, economic sanctions also bear the risk of a similarly targeted economic response by those targeted. These can include both defensive measures – such as laws prohibiting compliance with foreign sanctions – and retaliatory sanctions aimed at the economic interests of the countries behind the original sanctions measures.

The conflict between Russia and Ukraine has seen an unprecedented array of targeted sanctions deployed by Ukraine's allies, with a major impact on global trade and investment, especially in relation to commodities markets and related industries such as shipping, insurance and trade finance. These sanctions were first introduced in a limited fashion following the annexation of Crimea in 2014, but since the invasion of 24 February 2022 have expanded (and continue to expand) to cover a broad swathe of the Russian economy. The significant amounts of capital deployed around the world by Russian oligarchs and their businesses, many of whom are subject to targeted financial sanctions, means that investment managers and corporate service providers also need to tread warily to avoid falling foul of asset freezes and related measures. London's position as a global trading and investment hub, and the adoption of UK measures by British Overseas Territories and dependencies such as Jersey and the Cayman Islands, mean that a wide array of businesses in the financial sector are subject to UK sanctions legislation.

At the same time, businesses with interests or operations in Russia, or who transact with Russian counterparties, face Russian counter sanctions. Foreign investors in Russia whose business is adversely affected by counter sanctions may be able to rely on protections conferred under bilateral investment treaties (BITs), where these provide for investor-state dispute resolution. This article discusses examples of Russian counter-sanctions and when recourse to investment treaties may be appropriate.

THE RUSSIAN COUNTER-SANCTIONS

Since the beginning of the war against Ukraine, Russia has issued a number of counter-sanctions targeted against "unfriendly countries", presently defined as Andorra, Anguilla, Australia, the British Virgin Islands, Canada, member states of the European Union, Gibraltar, Iceland, Japan, the Republic of Korea, Liechtenstein, Macedonia, Micronesia, Monaco, New Zealand, North Macedonia, Norway, San Marino, Singapore, Switzerland, Taiwan (China), Ukraine, the UK (including Jersey), and the US.[1] These include:

- granting Russian companies the right to pay debts to foreign creditors from "unfriendly countries" only in rubles;[2]
- granting the Russian Federation, in the interests of national security, the right to use patents of persons from unfriendly states, including those having their main place of business or principally generating profit from those states, without consent[3] and without compensation;[4]
- requiring Russian natural persons and legal entities to sell 80% of foreign currency proceeds received from nonresidents pursuant to foreign trade operations since 1 January 2022, by exchanging such foreign currency proceeds into Russian rubles;[5]
- suspending money transfers from Russian accounts of nonresidents (natural persons or legal entities) from unfriendly countries to their accounts outside Russia for six months.[6]

Furthermore, a draft law on external management has been submitted to the Russian Parliament, which if passed will allow for an external manager to be appointed to take control of companies which cease their activities in Russia, including pursuant to foreign sanctions.[7] The relevant companies are defined as any company located in Russia (including branches of foreign companies) that:

- is controlled or owned as to at least 25% (in aggregate) by natural or legal persons from unfriendly states; and
- has material significance for economic stability, business, protection of rights and interests of citizens in Russia or in a Russian constituent territory.

Once appointed, the manager has power akin to those of an administrator of an insolvent company including the power to sell assets and wind up the company. Under the draft law, the appointment of an external manager has significant further consequences, including that counterparties may not terminate contracts with the company save with permission of the Russian court and entitling the company to continue using IP rights held by owners from unfriendly countries.

RUSSIA'S BILATERAL INVESTMENT TREATIES

Russia is party to over 80 BITs,[8] including with countries that have been designated as unfriendly states in the context of the counter-sanctions described above, including the UK, Canada, France, Germany, Spain, Norway, Switzerland and Ukraine.[9] Most of these BITs (and all of those with the aforementioned "unfriendly states") provide for investor-state dispute resolution, allowing investors of those states to bring claims against Russia for the breach of their rights under these treaties.

The investor-state dispute resolution clauses in BITs to which Russia is party typically provide that disputes between investors of one contracting party and the other contracting party may be submitted to arbitration under the Arbitration Rules of the United Nations Commission for International Trade Law (UNCITRAL),[10] ad hoc arbitration,[11] or for arbitration under the aegis of the Arbitration Institute of the Stockholm Chamber of Commerce (SCC).[12] For example, the UK-Russia BIT provides that such disputes can be submitted to ad hoc arbitration.[13] The Ukraine-Russia BIT provides for a choice between submission to the SCC or an ad hoc arbitration in keeping with the UNCITRAL Rules.[14]

The definition of "investors" under such BITs typically includes natural persons having the citizenship of nationality of a contracting as well as legal entities. For instance, the UK-Russia BIT refers to "any corporations, companies, firms, enterprises, organisations and associations incorporated or constituted under the law in force in the territory of that contracting party".

The "investments" protected by BITs generally include a broad range of assets. For instance, the definition of "investment" in the UK-Russia BIT includes movable and immovable property, any form of participation in a company or business enterprise, claims to money and to performance under a contract, intellectual property rights, rights conferred by law or under contract to undertake commercial activity.

In terms of substantive rights, these BITs contain a number of protections for investors and their investments, such as:

(i) the guarantee that they will be treated fairly and equitably, which is the broadest standard in investment treaty law and that which most often gives rise to successful awards for investors;
(ii) the guarantee that they will be afforded the most favoured nation treatment, which means that they can benefit from more favourable provisions of other investment treaties entered into by the host state;
(iii) protection against unlawful (as understood under international law) and uncompensated expropriation; and
(iv) free transfer of investments and returns to the country where the investor resides.

Whilst Russia's BITs tend to have dispute resolution clauses only referring explicitly to expropriation and free transfers, these clauses have often been interpreted broadly by investment treaty tribunals.

OPERATION OF THE BITs IN THE CONTEXT OF THE COUNTER-SANCTIONS

Some of the counter-sanctions currently in place could give rise to investment treaty claims by investors from "unfriendly states".

The counter-sanction allowing Russia to use patents without consent and without compensation in the interest of national security, could potentially constitute an unlawful and uncompensated expropriation as well as a breach of other standards of protection such as the fair and equitable treatment.

Likewise, the suspension of money transfers from Russian accounts of nonresidents (natural persons or legal entities) from unfriendly countries could constitute a breach of the free transfer provisions of Russia's BITs.

If the draft law on external management comes into force, there will be room for arguments that the companies from "unfriendly states" which are effectively taken over by external management are subjected to unlawful expropriation as well as a breach of other standards of protection such as the fair and equitable treatment.

It is likely that a large number of companies will be affected by this law. This is because there is a considerable number of companies from "unfriendly states" which recently decided to cease their activities in Russia. Furthermore, the proposed definition of companies that qualify for potential external management is extremely broad. It does not only include fully owned foreign companies but any company that is either controlled or (directly or indirectly, in aggregate) 25% or more owned by natural or legal persons from "unfriendly states".

In this context, investors from "unfriendly states" whose investments are affected by the counter-sanctions are likely to turn towards investment treaty claims as a potential remedy.

PERSPECTIVES

The multiplication of investment treaty claims in response to Russia's conduct would not be a new development.

After Russia's invasion of Crimea, dozens of investment treaty claims were commenced, mainly under the Ukraine-Russia BIT. The cases concerned various economic sectors including oil and gas, financial services, air transportation and real estate. A number of them have closed with substantial amounts being awarded against Russia.

For instance, in *Oschadbank v Russia* (PCA Case No. 2016-14), an arbitration commenced in 2016 in respect of the Crimean branch of Oschadbank, Oschadbank was awarded over US$1.1bn.

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Likewise, in *JSC CB PrivatBank v Russia* (PCA Case No. 2015-21), JSC CB PrivatBank commenced arbitration in 2015 in relation to its operations in Crimea encompassing loans, real estate and an ATM network. It was awarded US$1bn.

Whilst the Russian Federation is not, to date, complying voluntarily with these awards, it is a country with assets abroad, including through state-owned and controlled companies, and which are potentially available for investors to enforce against. In particular, where such assets are themselves frozen pursuant to sanctions, they may make attractive targets for enforcement, both politically and legally. ■

1 Government Directive No. 430-r of 5 March 2022: http://government.ru/en/docs/44745/.

2 Decree No. 95 of 5 March 2022: http://kremlin.ru/acts/news/67912.

3 Article 1360 of the Russian Civil Code: https://www.wipo.int/edocs/lexdocs/laws/en/ru/ru004enpart4.pdf.

4 Resolution No. 299 of 6 March 2022 "On amendments to paragraph 2 of the methodology for determining the amount of compensation paid to the patent holder when deciding to use an invention, utility model or industrial design without its consent, and the procedure for its payment": http://ips.pravo.gov.ru:8080/default.aspx?pn=0001202203070005

5 Decree 79 of 28 February 2022: https://cis-legislation.com/document.fwx?rgn=138018.

6 https://www.cbr.ru/press/event/?id=12783.

7 https://www.jdsupra.com/legalnews/update-draft-law-on-external-management-9055080/

8 List of Russia's BIT: https://investmentpolicy.unctad.org/international-investment-agreements/countries/175/russian-federation.

9 List of Russia's BIT: https://investmentpolicy.unctad.org/international-investment-agreements/countries/175/russian-federation.

10 See, eg Canada-Russia BIT: https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/632/download); France-Russia BIT: https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/1274/download.

11 Germany-Russia BIT: https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/1398/download ; Switzerland-Russia BIT: https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2227/download

12 See, eg Norway-Russia BIT which provides for a choice between the SCC and an ad hoc arbitration in keeping with the UNCITRAL Rules: https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2115/download

13 UK-Russia BIT: https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2235/download;

14 See, eg Ukraine-Russia BIT: https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2233/download

Further Reading:

- Financial sanctions: prohibitions extended to persons "connected with" Russia" (2022) 6 JIBFL 374.
- Are sanctions sustainable? (2022) 5 JIBFL 295.
- LexisPSL: Financial Services – Overviews – Sanctions compliance – overview.