Summary

In its 20 April 2016 judgment (the “Judgment”),1 the Hague District Court (the “Court”) set aside arbitration awards (the “Awards”) rendered in favour of three shareholders (the “Claimants”) in OAO Yukos Oil Company (“Yukos”) against the Russian Federation (“Russia”). The cases had been brought before a Permanent Court of Arbitration (“PCA”) Tribunal (the “Tribunal”) constituted under the Energy Charter Treaty (“ECT”), composed of Yves Fortier (President), Charles Poncet (claimants’ nominee) and Stephen Schwebel (respondent’s nominee).

As the place of arbitration was The Hague, the Hague District Court was the competent forum for Russia’s setting-aside applications. The Court granted the applications on the basis that the Tribunal lacked jurisdiction. Specifically, the Judgment held that provisional application of the ECT’s investor-state arbitration provision (Article 26) was contrary to Russian law and therefore not allowable pursuant to the ECT’s provisional application provision (Article 45).

Background

In 2002 Yukos was Russia’s largest oil and gas company. According to the Claimants, during the period from 2003 to 2006 the Russian government adopted a series of illegal measures resulting in the bankruptcy of Yukos. These included tax investigations, penalties for alleged underpayment of taxes, seizure of corporate property and the trial and imprisonment of the CEO of Yukos, Mikhail Khodorkovsky.

With a view to obtaining compensation, in early 2005, the three foreign-registered Claimants, Hulley Enterprises Limited, Yukos Universal Limited and Veteran Petroleum Limited, initiated three parallel investor-state arbitration cases against Russia under the ECT. The cases were filed pursuant to the UNCITRAL Arbitration Rules before the PCA in The Hague. In total, the Claimants requested compensation amounting to USD 114 billion. Russia defended the measures taken against Yukos on the basis that Yukos and its owners had been involved in embezzlement and tax-related offences. The Claimants rejected these allegations as politically motivated.

As provided for by Article 21(4) of the UNCITRAL Arbitration Rules of 1976, the Tribunal initially considered the issue of its own jurisdiction. As Russia had signed, but not ratified, the ECT, this largely turned on ECT Article 45(1). This provides:

“Each signatory agrees to apply this Treaty provisionally pending its entry into force for such signatory in accordance with Article 44, to the extent that such provisional application is not inconsistent with its constitution, laws or regulations.”

The Claimants and Russia submitted different interpretations of Article 45(1). The Claimants argued that Russia could only invoke Article 45(1) to justify non-application of the ECT if the concept of provisional application as a whole is inconsistent with Russia’s constitution, laws or regulations (the “all or nothing approach”). Russia argued that any individual provision of the ECT could be declared not provisionally applicable if that provision itself was inconsistent with Russia’s constitution, laws or regulations (the “piecemeal approach”). In

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1 The Court was composed of Judges Aarts, Kroft and Hofhuis.
Awards on Jurisdiction dated 30 November 2010, the Tribunal ruled in favour of the Claimant’s all-or-nothing approach. It therefore possessed jurisdiction over the dispute.

The Tribunal proceeded on 18 July 2014 to render Awards on Merits. They found in favour of many of the Claimants’ allegations and ordered Russia to compensate the Claimants in an amount of approximately USD 50 billion. This was the largest amount ever awarded in an international arbitration case but less than half the amount sought by the Claimants.

**Russia’s setting-aside application**

Russia requested that the Court set aside all six Awards on a number of grounds. The Court only considered the first, however: that the Tribunal lacked jurisdiction on the basis that Russia had never validly consented to investor-state arbitration with the Claimants. As explained above, this ground was linked to the provisional application of the ECT. In the Court’s view, the assessment of the Tribunal’s jurisdiction was based on two distinct questions: first, whether any alleged inconsistency between the ECT and Russia’s constitution, laws or regulations should be considered according to the all-or-nothing approach or the piecemeal approach; and second, whether, in particular, the investor-state arbitration provision of ECT Article 26 was inconsistent with Russia’s constitution, laws and regulations.

**Interpreting ECT Article 45(1)**

On the first point, the Court accepted Russia’s proposed interpretation of Article 45. It thus held that Russia was only bound by those treaty provisions which were reconcilable with Russian law. The Court paid particular attention to the phrase “to the extent that such provisional application is not inconsistent with its constitution, laws or regulations” and held that the term “to the extent” could not justify the “all or nothing” approach adopted by the Tribunal.

**Consistency of Article 26 with Russian law**

In light of its interpretation of Article 45(1), the Court proceeded to address the second question, namely whether the provisional application of the investor-state arbitration clause of Article 26 was inconsistent with Russia’s constitution, laws or regulations. In the Claimants’ submission, a provision of the ECT such as Article 26 could only be held inconsistent with Russian law if the Treaty provision concerned was expressly prohibited by some provision of Russian law. The Court rejected this position as being “too limited”. It held that the provisional application of Article 26 could be considered to be contrary to Russian law in the following circumstances: (a) if Russian law contained no legal basis for the same method of dispute settlement; (b) if the provision in question did not harmonise with Russia’s legal system; or (c) if the provision was irreconcilable with the principles that had been laid down in or could be derived from relevant Russian legislation.

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2 Judgment, paragraph 5.23.
3 Judgment, paragraphs 5.10, 5.11 and 5.18.
4 Judgment, paragraph 5.32.
5 Judgment, paragraph 5.33.
6 Id.
7 Id.
For the Court, the main issue was whether Russian law itself offered the option of arbitration as laid down in Article 26 ECT. As the response to this question was negative, the Court concluded that the arbitration clause of Article 26 ECT did not have a legal basis in Russian law and was incompatible with the principles laid down in that law.

**Ratification and the question of separation of powers**

In its final analysis, the Court emphasised that ECT Article 26 purported to establish a separate legal basis for the adjudication of certain disputes. According to the Russian constitution, international treaties that deviate from or supplement Russian legislation on dispute resolution can only enter into force upon ratification by the Parliament. On the basis of its analysis of Russia’s constitution, the Court arrived at the conclusion that an investor-state arbitration provision such as ECT Article 26 could not be applied, even provisionally, based only on the signature of the ECT by the Russian Government (the executive).

The Court thus held that the Tribunal did not have jurisdiction over the dispute. It accordingly set aside the Awards.

The Judgment is subject to appeal and the Claimants have already confirmed their intention to appeal.

**Commentary**

There is no doubt that the Judgment will not be the end of the debate on the issues it addresses. Even if confirmed on appeal, other arbitral tribunals, supervisory courts of other jurisdictions and indeed ICSID Annulment Committees will not be bound by the Judgment on the basis that they are not bound by the decisions of Dutch courts.

The case will be of concern to public international lawyers. Without explanation or support in public international law, the Court eviscerated the concept of provisional application as a general proposition of law. Contrary to the object and purpose of the ECT, not to mention the plain meaning of its text, the Court decided to transform the negative concept ‘not inconsistent with’ – which is the language of the text of the treaty – into a concept not found in Article 45(1) of a requirement that there be positive recognition or support in the relevant domestic law. For the Court, ECT investor-state arbitration can only be applied provisionally to Russia if Russian law itself directly mandates this already. Such casuistry renders the concept of provisional application meaningless.

Graham Coop, partner of Volterra Fietta and former General Counsel to the Energy Charter Secretariat, commented:

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8 Judgment, paragraph 5.41.
9 Judgment, paragraph 5.65.
10 Judgment, paragraph 5.84.
11 Judgment, paragraph 5.93; See also the final conclusion of the Court, “[t]he opinion delivered in this judgment leads to the final conclusion that from Article 45 paragraph 1 ECT it follows that based only on the signature of the ECT, the Russian Federation was not bound by the provisional application of the arbitration regulations of Article 26 ECT. The Russian Federation never made unconditional offer for arbitration, in the sense of Article 26 ECT. As a result, the defendants’ ‘notice of arbitration’ did not form a valid arbitration agreement.”
12 Judgment, paragraph 5.97.
"The ECT is not a masterpiece of drafting clarity, it is true. However, it does seem that the Court’s approach largely empties Article 45 of much of its potential utility, both generally and from the specific viewpoint of the ECT’s object and purpose. It is difficult to support the Court’s reading into Article 45(1) an inversion of the negative concept of ‘not inconsistent with’. If the only alternative to ratification is clause-by-clause legislative adoption, what scope is left for provisional application? In any event, this Judgment confirms that understanding and applying the legal principles related to the interpretation and application of the ECT requires experienced public international law practitioners."

The Judgment represents a significant intrusion by the Dutch courts into an international arbitration procedure and, in particular, an international tribunal’s ability to adjudge its own competence when clearly mandated to do so by the relevant instruments. This will undoubtedly cause potential parties to international arbitrations to consider carefully before selecting The Netherlands as the seat of any arbitration, whether under a commercial arbitration agreement or under an investment treaty. Given that courts of other jurisdictions (and ICSID annulment committees) are not required to follow the approach adopted by the Hague District Court, the Judgment clearly will be seen as a reason to avoid selecting The Netherlands as a place of arbitration in any case where one or more parties wish to invoke provisional application. Of course, parties seeking to avoid provisional application will no doubt be attracted to The Netherlands.