Portfolio Media. Inc. | 860 Broadway, 6th Floor | New York, NY 10003 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

How To Protect Your Co. From Russian Retaliatory Measures

Law360, New York (August 04, 2014, 7:32 PM ET) --

Marney Cheek

Russian lawmakers' recent threats to retaliate against U.S. and European companies in response to new sanctions imposed by the United States and the European Union are a reminder that investments in Russia are subject to meaningful political risk. Companies would thus be wise to consider now how they can mitigate the exposure to their investments in Russia. What can these companies do? The answer is to consider both how their investments are structured and how any agreements governing their investments address dispute resolution. These considerations are critical to ensuring that companies invested in Russia have remedies available if they find themselves in a dispute with Russian authorities.

The Importance of Access to International Arbitration

Companies with investments in Russia are appropriately wary of relying on Russia's courts to uphold their rights in the event of a dispute with the state. Indeed, the rubber-stamping of the Kremlin's expropriation of the Yukos oil company by Russia's courts between 2003 and 2007 demonstrated that the country's courts cannot be relied upon to dispense impartial justice in politically sensitive cases.

Thus, for most foreign companies, the preferred dispute-resolution mechanism is international arbitration, which provides the neutral forum that Russia's courts do not. But forethought is required to ensure that international arbitration is even an option. And getting the most of international arbitration requires still more forethought.

Securing a Gateway to International Arbitration

To arbitrate a dispute against a sovereign in an international forum, a foreign investor must be able to establish that the sovereign has consented to arbitration. Without such consent, the investor will not have a jurisdictional basis to pursue its claim. Thus, when investing in Russia, foreign companies should consider how they will demonstrate Russia's consent to arbitration if a dispute later arises.

Foreign investors typically have two options for establishing Russia's consent. First, an investor can include a dispute-resolution clause providing for international arbitration in any investment agreement the investor has with Russia. Second, in the event of a dispute, they can avail themselves of the protections of an investment treaty with Russia providing for arbitration of investment disputes. Such treaties include bilateral investment treaties, or "BITs," and in the case of energy companies, the Energy

Charter Treaty, or "ECT." With respect to the ECT, however, although Russia signed the treaty in 1991 and thereby became subject to its provisional application, an investor should expect Russia to argue that the period of provisional application was terminated by Russia's declaration in August 2009 that it did not intend to ratify the treaty.

While either of these avenues — i.e., an investment agreement or treaty — on its own may be sufficient to confer arbitral jurisdiction, they are not mutually exclusive. Indeed, in some circumstances, an investor may be able to demonstrate Russia's consent to arbitration both in an applicable treaty and in the provisions of the governing contract.

Treaty-Based Jurisdiction

While Russia has BITs with many countries, it does not have a BIT with the United States — a crucial fact for any U.S. company invested in Russia. (While Russia and the United States negotiated a BIT, the Duma never ratified it.) In the BITs to which Russia is party, however, Russia has committed, for example, to treat investors from its treaty partners' countries in a fair and equitable manner, not to discriminate against investors from those countries on the basis of nationality, and not to expropriate their investments except under certain conditions and upon payment of adequate compensation.

That said, it is important to note that in many of its BITs, Russia has consented to arbitral jurisdiction for certain kinds of investment disputes but not others. Indeed, the scope of Russia's consent to arbitration varies from treaty to treaty, with some treaties providing for arbitral jurisdiction over a greater variety of disputes than others. For example, many of Russia's BITs are legacies from the late Soviet era and provide for arbitration only for limited types of disputes. By contrast, many BITs negotiated by Russia in the late 1990s provide investors with much broader arbitral rights, reaching a wide variety of disputes.

These variations mean that the nationality of the investor can have a significant effect on the quality of dispute resolution available. Without a U.S.-Russia BIT, a U.S. company that invests directly in Russia lacks altogether the protection of BIT-conferred arbitral rights. But Spanish investments in Russia, for example, would obtain the arbitral protections set forth in the BIT entered into by Spain and the Soviet Union in 1990, which include the right to arbitrate disputes concerning "the amount and method of payment of compensation for expropriation." Better still, Danish investors in Russia can avail themselves of the BIT entered into by Denmark and Russia in 1998, which extends to "[a]ny dispute which may arise … in connection with an investment on the territory" of Russia. Thus, multinational companies invested in Russia should consider structuring their investments with care, with an eye toward protecting the investment should a dispute arise with Russian authorities.

Other provisions may also be relevant to determining whether international arbitration is available to a foreign investor in Russia. Some Russian BITs require more substantial contacts with the territory of the treaty party than others in order to obtain the protections of the BIT. For example, the Russia-Switzerland BIT's definition of "investor" requires not only that a Swiss company invested in Russia be formed under the laws of Switzerland, but also that it have its "seat" in Switzerland and that it be engaged in real economic activity there.

Contract-Based Jurisdiction

A U.S. or European company or a foreign-based subsidiary of a U.S. or European company that enters into an investment agreement directly with Russia — whether with Russia's federal government, a local government, or a governmental agency — should seek to include a broad dispute-resolution clause in its investment agreement that provides for international arbitration of disputes arising from its investment. This is important not only for U.S. companies investing directly in Russia and therefore without the protection of a BIT, but also for any company that can avail itself only of a BIT containing Russia's consent to arbitrate a limited category of disputes. By entering into an investment agreement, a company can remove some of the barriers or limitations to arbitral jurisdiction that may exist under a BIT.

Effective Protection for Existing Investments

The best time for a company investing in Russia to consider its dispute-resolution options is before making its investment. But if a company has already invested in Russia and is either not covered by a BIT or covered by a BIT that grants inadequate access to international arbitration, the company may still be able to improve its options in the event that a dispute arises. Indeed, there may be a range of ways in which companies can achieve this objective.

It is important to note, however, that any such measures should be taken before a dispute with Russia arises. Companies that seek to restructure their investments to improve their access to arbitration after a dispute has crystallized run the risk that their claims may be rejected for lack of jurisdiction. It is therefore imperative for companies to consider access to treaty and other investment protections well in advance of an actual dispute. Given the state of relations between Russia and the West, that time is now.

—By Marney Cheek, Jonathan Gimblett and David Pinsky, Covington & Burling LLP

Marney Cheek and Jonathan Gimblett are partners in Covington & Burling's Washington office, and David Pinsky is a partner in the firm's New York office. All three were part of the team at Covington that successfully represented Spanish investors in Yukos in an arbitration against Russia related to the expropriation of the company, Quasar de Valors v. The Russian Federation. They advise clients on dispute resolution and investment planning, as well as serve as counsel in investor-state and commercial arbitrations.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.
