State consent to arbitrate and waiver of immunity determined by clear wording of arbitration agreement

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AUTHORS

Marie Berard

Anna Kirkpatrick

James Dingley

Introduction

It is well established that a state's consent to refer disputes arising under a bilateral investment treaty to arbitration constitutes an agreement in writing under Section 9 of the State Immunity Act 1978 and that such consent can potentially be effective to waive any immunity from which the state may otherwise have benefitted pursuant to Section 1 of the act in any related proceedings before the English courts.(1)

In *PAO Tatneft v Ukraine*,(2) the High Court:

- confirmed that there was no bar to Ukraine raising jurisdictional arguments that it had not previously raised before the arbitral tribunal in the context of submissions on state immunity pursuant to Section 1 of the State Immunity Act; and
- rejected arguments by Ukraine that an *ex parte* order for the enforcement of an award rendered in favour of Tatneft pursuant to the Russia-Ukraine bilateral investment treaty should be set aside on the grounds that the disputes that formed the subject of the award fell outside the scope of Ukraine's consent to refer disputes to arbitration under said treaty (such that it still benefitted from state immunity in respect of those issues before the English courts).

Facts

In 1995 Tatneft (one of Russia's largest oil-producing companies) became a shareholder in CJSC Ukrtatnafta Transitional Financial and Industrial Oil Company (Ukrtatnafta), together with Ukraine and Tatarstan. Ukrtatnafta owned and operated the Kremenchug refinery, the largest oil refinery in Ukraine.

In 1999 two companies, Seagroup International Inc (a US company) and AmRuz Trading AG (a Swiss company) acquired minority shareholdings in Ukrtatnafta.

From 2001 on, various challenges were made before the Ukrainian courts as to the validity of AmRuz's and Seagroup's acquisition of their minority shareholdings.

These challenges did not prevail until May 2007, at which point a Ukrainian court declared that their shareholdings should be held in custody by Naftogaz, the Ukrainian state-owned energy company.

In September 2007 the share purchase agreements were declared invalid by the Ukrainian courts. That decision was upheld on appeal in October 2007.

On 19 October 2007 (according to Tatneft), the Kremenchug refinery was seized by force, allegedly with the support and assistance of the Ukrainian armed forces.

On 11 December 2007 Tatneft issued a notice of dispute pursuant to Article 9 of the Russia-Ukraine bilateral investment treaty.

On 18 December 2007 Tatneft bought nearly 50% of the shares in AmRuz.

On 19 December 2007 the Ukrainian general prosecutor commenced proceedings before the Ukrainian courts seeking to invalidate the resolutions of Ukrtatnafta pursuant to which Tatneft had been permitted to acquire its shareholding in that company for cash rather than oil fixtures (as originally envisaged).

On 24 December 2007 Tatneft bought 100% of the shares in Seagroup. In 2008 and 2009 the Ukrainian courts held that the share purchase agreements by which Tatneft had acquired its shareholding in Ukrtatnafta were invalid.

In May 2008 Tatneft served a notice of arbitration on Ukraine pursuant to the Russia-Ukraine bilateral investment treaty. Tatneft alleged that through a series of actions in which Ukraine was complicit it had been deprived of its shareholdings in Ukrtatnafta and that Ukraine had therefore violated its obligations under the Russia-Ukraine bilateral investment treaty.

In September 2010 the tribunal rendered an award on jurisdictional issues, in which it rejected various jurisdictional arguments advanced by Ukraine and confirmed that it had jurisdiction to decide the dispute before it.

In July 2014 the tribunal rendered an award on the merits of the dispute (the merits award), in which it held that Ukraine had breached the obligation to treat Tatneft fairly and equitably in relation to its own shares in Ukrtatnafta and AmRuz's and Seagroup's shares in Ukrtatnafta. The tribunal ordered that Ukraine pay Tatneft $112 million (plus interest).

In April 2017 Tatneft issued an arbitration claim form in the English courts seeking an *ex parte* order to enforce the merits award. The order allowing enforcement of the merits award was ultimately granted in August 2017 and served on Ukraine in October 2017.

In January 2018 Ukraine applied to set aside the enforcement order.

Decision

Tatneft's position

Tatneft submitted that, as arguments concerning the application of Section 9 of the State Immunity Act turned on whether there was an agreement to arbitrate disputes, Ukraine's arguments were jurisdictional ones that should have been raised before the tribunal and that, by analogy with the application of Section 73 of the Arbitration Act 1996 (regarding the loss of the right to appeal against an award on jurisdictional grounds under Section 67 of the act), as Ukraine had not raised these arguments at that juncture, it had lost the right to do so before the English courts at the enforcement stage.

The English court disagreed, holding that:

- there was no equivalent of Section 73 of the Arbitration Act for the purposes of the State Immunity Act:

  There is nothing in the SIA [State Immunity Act] *which suggests that there can be a foreclosure of the points which the State may raise as to the applicability of the immunity afforded by the SIA by reason of what may have occurred in front of an arbitral tribunal*;

- it must give effect to Section 1 of the State Immunity Act unless convinced that Ukraine had agreed in writing to submit a dispute to arbitration; and
- it must therefore proceed to examine whether there was such an agreement in writing for the

purposes of Section 9 of the State Immunity Act in the present instance.

Ukraine's position

Ukraine argued that it was not subject to the jurisdiction of the English courts as it still benefitted from the state immunity afforded to it pursuant to Section 1 of the State Immunity Act.

Both parties accepted that:

- Ukraine was entitled to state immunity (pursuant to Section 1 of the act) unless it had lost such immunity pursuant to Section 9 of the act;(3)
- treaties which contain unilateral offers by states to refer disputes to arbitration (such as Article 9 of the Russia-Ukraine bilateral investment treaty) can give rise to such a written agreement for the purposes of Section 9 of the act; and
- enforcement proceedings of the kind commenced by Tatneft before the English court were "proceedings... which relate to the arbitration" for the purposes of Section 9 of the act (as per *Svenska Petroleum Exploration AB v Lithuania*).

However, Ukraine argued that the specific disputes that were resolved by the tribunal in the merits award fell outside the scope of its consent to arbitration as contained in Article 9 of the Russia-Ukraine bilateral investment treaty, such that:

- Article 9 was not an agreement in writing in respect of those specific disputes for the purposes of Section 9 of the State Immunity Act;
- absent an agreement in writing within the meaning of Section 9 of the act, the state immunity from which Ukraine benefitted pursuant to Section 1 of the act remained intact; and
- correspondingly, the English courts therefore did not have jurisdiction over Ukraine for the purposes of enforcing the merits award resolving those specific disputes.

Ukraine relied upon three main arguments.(4)

Ukrtatnafta, AmRuz and Seagroup Shareholdings – fair and equitable treatment

In the underlying arbitration, Tatneft had argued that it could benefit from the fair and equitable treatment standard of protection contained in the Ukraine-UK bilateral investment treaty on the basis of the 'most favoured nation' provision contained in Article 3(1) of the Russia-Ukraine bilateral investment treaty.

The tribunal agreed and awarded Tatneft damages on the basis of a breach of the fair and equitable treatment standard of protection.

Before the English courts, Ukraine argued that the Russia-Ukraine bilateral investment treaty did not expressly provide for the fair and equitable treatment standard of protection; the exclusion of this standard of protection (by comparison to the number of other bilateral investment treaties into which Russia and Ukraine had entered, which included the fair and equitable treatment standard of protection) was therefore significant. It was therefore the intention that claims for alleged breaches of the fair and equitable treatment standard fell outside the scope of the unilateral offer to refer disputes to arbitration contained in Article 9 of the Russia-Ukraine bilateral investment treaty, which was therefore not an agreement in writing for the purposes of Section 9 of the State Immunity Act.

Tatneft argued that the only jurisdictional issue was whether a claim for breach of the fair and equitable treatment standard came within the scope of the arbitration agreement contained in Article 9 of the Russia-Ukraine bilateral investment treaty.

The English court agreed with Tatneft. While highlighting the breadth of the wording used in Article 9 of the Russia-Ukraine bilateral investment treaty ("in the case of *any dispute*... which may arise *in connection with the investments*" (emphasis added)), the English court held that Ukraine had agreed to refer any dispute to arbitration. The question of whether Ukraine should have afforded Tatneft the protection of the fair and equitable treatment standard was therefore a dispute in connection with Tatneft's investments in Ukrtatnafta, which fell within the scope of Ukraine's consent to arbitration and was therefore a merits issue to be decided by the arbitral tribunal.

AmRuz and Seagroup Shareholdings – no investment

Ukraine argued that its agreement to refer disputes to arbitration in accordance with Article 9 of the Russia-Ukraine bilateral investment treaty applied only to disputes "arising in connection with investments" as defined in Article 1(1) of the treaty.

It asserted that:

- Tatneft's shareholdings in AmRuz and Seagroup were not 'qualifying investments' within the meaning of Article 1(1) of the Russia-Ukraine bilateral investment treaty because:
    - shares in Swiss and US companies, respectively, were not "assets... within the territory of the other Contracting Party" (ie, Ukraine); and
    - their acquisition by Tatneft did not result in a contribution of capital into Ukraine – only to the shareholders from whom the shareholdings were purchased; and
- Tatneft was therefore entitled to benefit from (and had not waived) state immunity before the English courts in respect of its claims regarding its shareholdings, as they fell outside the scope of Article 9 of the treaty.

While Tatneft accepted that Ukraine's argument concerning the contribution of capital was one that questioned the tribunal's jurisdiction under the Russia-Ukraine bilateral investment treaty, it maintained that Ukraine was wrong as a matter of interpretation of the treaty, which properly construed, envisaged such an indirect acquisition of shares in a Ukrainian company as a qualifying investment.

With reference to the Vienna Convention of the Law of Treaties, the English court agreed with Tatneft, holding that:

- the plain meaning of 'investments' under Article 1(1) of the Russia-Ukraine bilateral investment treaty included "assets and intellectual property of *all kinds* that are *invested* by the investor" (emphasis added);
- there was therefore no requirement for an active process of the commitment of capital into Ukraine by Tatneft;
- Tatneft's shareholdings in AmRuz and Seagroup did therefore constitute 'investments' within the meaning of Article 1(1) of the treaty; and
- disputes in respect of those investments fell within the scope of Ukraine's consent to arbitration contained in Article 9 of the treaty, which therefore constituted an agreement in writing for the purposes of Section 9 of the State Immunity Act, which was effective to waive Ukraine's state immunity.

AmRuz and Seagroup Shareholdings – timing and abuse of rights

Ukraine also maintained that, to the extent that any investment had been made into Ukraine, it had not been made by Tatneft as an "investor of one Contracting Party" following its acquisition of the shares, but beforehand by AmRuz and Seagroup.

Rationae temporis

Ukraine argued that Article 9 of the Russia-Ukraine bilateral investment treaty should be construed as being subject to a temporal limitation (ie, by reference to the relationship between the date on which a protected qualifying investment was acquired and the date of the occurrence of the alleged breach of the relevant standard of protection).

While the English court acknowledged that Ukraine's argument was in line with jurisprudence, based on the facts of the case, it held Tatneft had complied with the temporal limitation, such that the tribunal did not lack jurisdiction *rationae temporis.*

It was only in 2008 (when the Ukrainian Supreme Court confirmed the annulment of the relevant share purchase agreements) or 2009 (when the shareholdings in AmRuz and Seagroup were ultimately sold to third parties) that it became clear that Tatneft was being deprived of its indirect shareholding in Ukrtatnafta – by which time Tatneft had already made its qualifying investment (the critical date being that on which the state adopts the disputed measure, even when such measure represents the culmination of a process which may have started earlier).(5)

Abuse of rights
Ukraine further argued that:

- even if the shares had been acquired before the breach of the Russia-Ukraine bilateral investment treaty occurred, it would be an abuse of rights for Tatneft to refer the dispute to arbitration pursuant to the treaty, as it was reasonably foreseeable (and, in fact, foreseen) at the time of the acquisition of the qualifying investment that a dispute would ensue (such that the acquisition was made for the sole purpose of bringing that dispute within the scope of the treaty); and
- Ukraine's agreement to refer disputes to arbitration under Article 9 of the Russia-Ukraine bilateral investment treaty did not extend to abusive claims, such that Ukraine's state immunity in respect of such claims remained intact, as there was no agreement in writing for the purposes of Section 9 of the State Immunity Act.

The English court disagreed, holding that an alleged abuse of rights on Tatneft's part was not a jurisdictional issue (ie, whether such claims fell within the scope of Article 9 of the Russia-Ukraine bilateral investment treaty and could therefore be heard by the arbitral tribunal), but rather a matter that went to the admissibility of the claim (ie, whether the claim was barred or defective in some way) to be decided by the arbitral tribunal.

Ukraine's *rationae temporis* and abuse of rights arguments failed to demonstrate that disputes regarding Tatneft's shareholdings in AmRuz and Seagroup fell outside the scope of Ukraine's consent to arbitration contained in Article 9 of the Russia-Ukraine bilateral investment treaty. Accordingly, Article 9 of the treaty constituted an agreement in writing in respect of these disputes for the purposes of Section 9 of the State Immunity Act, which was therefore also effective to waive Ukraine's state immunity.(6)

Comment

While the judgment in *PAO Tatneft v Ukraine* could be seen as affording a state party an additional ground on which to resist the enforcement against it of an unfavourable arbitration award (on the basis that it had not agreed in writing to submit certain disputes to arbitration), the chances of such state immunity arguments being successful seem relatively low, particularly if the underlying arbitration agreement in question is broadly worded (eg, "every dispute arising out of or in connection with this Agreement") or does not provide for express carveouts for certain categories of dispute.

This case highlights the importance of ensuring that any agreement being entered into with a state party contains carefully drafted arbitration provisions and appropriately worded waiver of immunity language to ensure that the dispute resolution regime is fit for purpose – ideally with the benefit of an analysis of the applicable state immunity regime in those jurisdictions in which enforcement of any resulting award may ultimately be sought.

For further information on this topic please contact Marie Berard, Anna Kirkpatrick or James Dingley at Clifford Chance LLP by telephone (+44 20 7006 1000) or email (marie.berard@cliffordchance.com, anna.kirkpatrick@cliffordchance.com or james.dingley@cliffordchance.com). The Clifford Chance website can be accessed at www.cliffordchance.com.

Endnotes

(1) *Svenska Petroleum Exploration AB v Lithuania* [2006] EWCA Civ 1529.

(2) [2018] EWHC 1797.

(3) Section 9 of the State Immunity Act provides as follows: "Where a State has agreed in writing to submit a dispute which has arisen, or may arise, to arbitration, the State is not immune as respects proceedings in the courts of the United Kingdom which relate to the arbitration".

(4) Ukraine also advanced arguments that Tatneft had not complied with its duty of full and frank disclosure when making its application to allow enforcement of the merits award on the basis that it had failed to alert the English court to state immunity arguments that Ukraine might raise (as well as to the existence of parallel enforcement proceedings before the courts of France, the United States and Russia), which arguments (had they been raised) might have resulted in an *inter partes* hearing. The English court rejected these arguments.

(5) *Philip Morris Asia Limited v The Commonwealth of Australia*, PCA Case 2012-12, Award of 17 December 2015, paragraph 529.

(6) Leave was granted to appeal to the Court of Appeal on the issue of qualifying investments.
