

Court of Appeal in The Hague overturns District Court decision and revives Yukos awards

by *Jurjen de Korte* and *Geert Wilts*, *Van Oosten Schulz De Korte Advocaten*

Legal update: case report | Published on 26-Feb-2020 | United Kingdom

In *Hulley and others v Russian Federation* (ECLI:NL:GHDHA:2020:234), the Court of Appeal in The Hague overturned the District Court of The Hague judgment setting aside the awards that ordered Russia to pay around USD 50 billion in damages to the former majority shareholders in Yukos. With this decision, the appeal court has reinstated the awards.

Background

Facts

Decision

Did an arbitration agreement exist due to provisional application of the ECT?

Did the Yukos shareholders qualify as investors?

Did the tribunal have jurisdiction to hear claims related to taxation measures?

Did the tribunal violate its mandate?

Was the composition of the tribunal in violation of the UNCITRAL Rules?

Did the award lack meaningful reasoning?

Was there a violation of public policy?

Comment

Speedread

The Court of Appeal in The Hague has overturned the District Court of The Hague decision setting aside the awards issued in favour of the former majority shareholders in Yukos. It ruled that the tribunal did have jurisdiction to rule on the dispute under the Energy Charter Treaty (ECT) and dismissed Russia's other grounds for setting aside the awards.

In 2004, the former majority shareholders in Yukos initiated arbitration proceedings against Russia based on Article 26 of the ECT. The tribunal ruled that it had jurisdiction to hear the dispute in interim awards, and in its final awards, it ordered Russia to pay around USD 50 billion in damages.

Russia was successful in setting aside the interim and final awards before the District Court in The Hague.

The Court of Appeal first ruled that the court may take into account arguments regarding the jurisdiction of the tribunal submitted by a party for the first time in setting aside proceedings. It then held that provisional application of any provision of the ECT depended on whether such provisional application

would be inconsistent with a rule of Russian law. Under this interpretation, the Court of Appeal found that there was no Russian law provision prohibiting provisional application of (categories of) ECT treaty provisions. The Court of Appeal dismissed Russia's other jurisdictional arguments.

The Court of Appeal also dismissed Russia's other grounds for setting aside the awards. It found that the tribunal had not violated its mandate, that it could not be established that the composition of the tribunal was in violation of the applicable rules or that the award lacked any meaningful reasoning and that there were no grounds to set aside the award due to violation of public policy.

The Court of Appeal's finding that the tribunal had jurisdiction in this case under Article 26 of the ECT remains a controversial issue due to the question of whether the provisional application of Article 26 of the ECT was allowed under Russian law. In addition, the judgment shows that if an arbitral tribunal asserted a ground for its jurisdiction that was later found to be incorrect, this does not constitute a ground to set aside the award if it is found that there is another ground for jurisdiction of the tribunal.

The judgment of the Court of Appeal is subject to a further (limited) appeal to the Dutch Supreme Court. (*Hulley and others v Russian Federation* (ECLI:NL:GHDHA:2020:234) (18 February 2020).)

Background

When an arbitration has its seat in The Netherlands, Article 1065(1) of the [Dutch Civil Procedural Code](#) (*Wetboek van Burgerlijke Rechtsvordering*) as in force until 1 January 2015 (on which date the Dutch arbitration law was amended) provides the grounds for setting aside an arbitral award, including the following:

- Absence of a valid arbitration agreement (*Article 1065(1)(a)*).
- Composition of the tribunal was in violation of the applicable rules (*Article 1065(1)(b)*).
- Tribunal violated its mandate (*Article 1065(1)(c)*).
- Award is not duly signed or lacks reasoning *Article 1065(1)(d)*).
- Award is in violation of public policy (*Article 1065(1)(e)*).

Article 31(1) of the [Vienna Convention on the Law of Treaties](#) (VCLT) provides that a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose. Pursuant to Article 31(3)(3) of the VCLT, together with the context of a treaty, any subsequent practice in the application of the treaty that establishes the agreement of the parties regarding its interpretation shall also be taken into account. In addition, pursuant to Article 32 of the VCLT, amongst other things, the preparatory work of the treaty (*travaux préparatoires*) may be taken into account to confirm the meaning pursuant to Article 31 of the VCLT or to determine the meaning when the interpretation under Article 31 of the VCLT leaves the meaning ambiguous or obscure or leads to a manifestly absurd or unreasonable result.

Article 45 of the [Energy Charter Treaty](#) (ECT) provides in relevant part:

"(1) 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.

(2) (a) Notwithstanding paragraph (1) any signatory may, when signing, deliver to the Depository a declaration that it is not able to accept provisional application. The obligation contained in paragraph (1) shall not apply to a signatory making such a declaration. Any such signatory may at any time withdraw that declaration by written notification to the Depository.

...

(3) (a) Any signatory may terminate its provisional application of this Treaty by written notification to the Depository of its intention not to become a Contracting Party to the Treaty. Termination of provisional application for any signatory shall take effect upon the expiration of 60 days from the date on which such signatory's written notification is received by the Depository."

Article 26 of the ECT contains the dispute resolution provision providing for arbitration between investors and host states.

For further discussion of arbitrating under the ECT, see [Practice note, Investment arbitration under the Energy Charter Treaty](#).

For further discussion of jurisdiction and admissibility issues in investment treaty arbitration including the definition of investor and investment, see [Practice notes, Jurisdiction and admissibility in investment arbitration: overview; Definition of investment in international investment law; What is an investor for the purposes of investment treaty arbitration](#).

For discussion of corruption in investment treaty arbitration, see [Practice note, Bribery, corruption and money laundering in international arbitration](#).

Facts

Hulley Enterprises Ltd, Veteran Petroleum Ltd and Yukos Universal Ltd were shareholders in Russian oil company Yukos, that was declared bankrupt in 2006. In 2004, the shareholders initiated arbitration proceedings against Russia based on Article 26 of the ECT claiming that Russia expropriated their investments. In 2009, the tribunal rejected Russia's preliminary jurisdiction and admissibility objections in interim awards. In final awards in 2014, the tribunal ultimately ruled that Russia violated Article 13(1) of the ECT (expropriation) and ordered it to pay around USD50 billion in damages. The tribunal held that Russia orchestrated Yukos' bankruptcy by imposing a number of taxation and recovery measures aimed at eliminating Mikhail Khodorkovsky, the Yukos chairman, as potential political opponent of Vladimir Putin (see [Legal update, Majority shareholders in Yukos awarded US\\$50 billion](#)).

In November 2014, Russia initiated setting aside proceedings against the interim and final awards.

In 2016, the District Court of The Hague granted the Russian Federation's application to set aside the awards, as well as the 2009 interim awards, deciding that the tribunal did not have jurisdiction to hear the claims. It found, interpreting Article 45(1) of the ECT (which provides for provisional application pending entry into force of the ECT, provided such application is not inconsistent with a state's domestic laws), that provisional application of the arbitration clause contained at Article 26 of the ECT violated the Russian constitution (see [Legal update, The setting aside of the Yukos awards: full update](#)).

In an interim judgment of 25 September 2018, the Court of Appeal in The Hague addressed the admissibility of some of Russia's arguments and found in Russia's favour in respect of the admissibility of its unclean hands arguments and its arguments on the interpretation of the ECT. However, it honoured the shareholders' objections in respect of Russia's assertions on fraud committed by the shareholders in the arbitration (see [Legal update, Court allows Russia's unclean hands argument against former Yukos shareholders \(Court of Appeal in The Hague\)](#)).

Following the interim judgment, the parties filed further submissions and a hearing took place in September 2019.

Decision

The Court of Appeal in The Hague overturned the District Court judgment and held that the tribunal had jurisdiction to rule on the dispute between the shareholders. It dismissed the other grounds argued by Russia to set aside the awards.

Did an arbitration agreement exist due to provisional application of the ECT?

First, the court ruled that whether or not an arbitration agreement existed depended on the interpretation of Articles 26 and 45 of the ECT under Russian law, subject to the provisions of Articles 31 and 32 of the VCLT. The Court of Appeal assessed that in 1994, the ECT was signed on Russia's behalf but that it never entered into force in accordance with Article 44 of the ECT in the absence of an instrument of ratification, acceptance or approval by Russia.

The court therefore considered whether the ECT applied provisionally to the extent that this was not inconsistent with Russia's constitution, laws or regulations (the limitation clause; *Article 45(1) of the ECT*). The Court of Appeal ruled that a court may take into account arguments brought forward by a party for the first time in setting aside proceedings, as state courts have the final say as to whether an arbitration agreement exists. Moreover, the court held that this approach contributes to the effectiveness of arbitration proceedings, as it avoids arbitral awards being setting aside only because the tribunal failed to assert the correct reason for its jurisdiction.

In accordance with Article 31 of the VCLT, the Court of Appeal considered the extent to which the application of the arbitration provision of Article 26 of the ECT fell within the limitation clause. The Court of Appeal followed the interpretation given by the shareholders in the setting aside proceedings, namely, that provisional application of any provision of the ECT depended on whether such provisional application itself would be inconsistent with a rule of Russian law.

Contrary to the tribunal's decision, the Court of Appeal ruled that a signatory that has not filed a declaration objecting to provisional application on the basis of Article 45(2)(a) of the ECT, can still invoke the limitation clause. Given that the purpose of the ECT is to promote investments in the energy field, the court interpreted the limitation clause as relating to a signatory's legislation on the provisional application of treaties, as opposed to a signatory's legislation on investment arbitration (in case of Article 26 of the ECT). The *travaux préparatoires* of the ECT confirmed the

Court of Appeal's interpretation of Article 45 of the ECT. Applying this interpretation, the Court of Appeal ruled that there was no Russian law prohibiting provisional application of (categories of) treaty provisions.

For the sake of completeness, the Court of Appeal also addressed the interpretation given to Article 45(1) by Russia, which is that the possibility of applying a treaty provisionally, is limited to treaties that are not contrary or supplemental to Russian federal laws. Russia argued that, without parliamentary approval (which was not given to the ECT), its government could not grant to third parties authority to decide disputes, whose jurisdiction belongs to its judiciary. However, the court ruled that Russia's legislation did enable international arbitration of investment disputes. Moreover, Russia's government's authority to agree to the provisional application of unratified treaties was not limited under Russian law. Amongst other things, this was evidenced by the fact that for a number of years Russia applied several treaties provisionally pending ratification thereof. The court dismissed Russia's argument that arbitration in accordance with Article 26 of the ECT would be of a public law nature and could therefore not be subject to arbitration. The court also ruled that Article 26 of the ECT was not in violation of a number of provisions of Russian substantive law submitted by Russia. It therefore concluded that the tribunal had jurisdiction over the dispute between the Yukos shareholders and Russia on the basis of Article 26 of the ECT.

Did the Yukos shareholders qualify as investors?

The court then considered whether Russia's other jurisdictional objections had merit. Applying Article 31 of the VCLT, the court ruled that each of the shareholders qualified as an "investor" within the meaning of Article 1(7) of the ECT, investing in a country other than its own, as the seat of incorporation of the Yukos shareholders (Cyprus and Isle of Man) was outside of Russia.

The court ruled that there was no legal principle of international law holding that investment treaties do not offer protection to entities fully controlled by subjects of the host country, nor that an active economic contribution into the host country was required for the definition of 'investment' under Article 1(6) of the ECT. International investments made in violation of the laws of the host country were not to be protected, but this did not necessarily lead to the tribunal's lack of jurisdiction.

Did the tribunal have jurisdiction to hear claims related to taxation measures?

According to the court, Article 21(1) of the ECT, which provides that nothing in the ECT creates rights or imposes obligations with respect to taxation measures, does not relate to the jurisdiction of the tribunal. Even if it did, Article 21(1) only applies to *bona fide* taxation measures, and the measures imposed on Yukos and its shareholders were not *bona fide*.

Did the tribunal violate its mandate?

The court then considered whether the tribunal had violated its mandate. The fact that the tribunal failed to submit the dispute to the competent Russian tax authorities in accordance with Article 21(5)(b) of the ECT was held insufficient to justify setting aside of the award, as it was inconceivable that Russia suffered any disadvantage as a result. The Court of Appeal further ruled that arbitrators have a wide margin of appreciation to assess the amount of damages, and that the calculation of damages by the tribunal (consisting of the value of the Yukos shares and missed dividends) fell well within that scope, also because it concerned a hypothetical situation (the situation in which Yukos would not have been expropriated) and Russia had failed to provide a concrete alternative damages calculation.

The court dismissed further arguments by Russia that the tribunal guessed what Russia might have done and that it thus went beyond the procedural debate.

Was the composition of the tribunal in violation of the UNCITRAL Rules?

Further, the court found that it could not be established that the composition of the tribunal was in violation of the applicable UNCITRAL rules. Even if the tribunal secretary had drafted parts of the award it was not established that the tribunal secretary took material decisions.

Did the award lack meaningful reasoning?

The court also ruled that it had not been established that the award lacked any meaningful reasoning but, at most, that the reasoning was incorrect, which does not constitute a ground for setting aside an award.

Was there a violation of public policy?

Lastly, the court dismissed Russia's public policy arguments. Amongst other things, Russia argued that the shareholders defrauded the tribunal and hid directly relevant evidence. The court did not address this argument and referred to its previous judgment of 25 September 2018, in which it ruled that such arguments at most made out a case for revocation of the award, which is to be brought within three months of the date of the award, in the absence of which such arguments cannot be invoked in setting aside proceedings (such as was held to be the case here).

The court then turned to the "unclean hands" argument, which, in summary, concerned fraudulent, corrupt and illegal activities by the shareholders. The court found that the tribunal had not failed to take into account these alleged activities but had rightfully ruled that such activities were not relevant in relation to the shareholders' claims, as only illegalities that occur at the time the investments are made, are relevant. The alleged illegalities were performed by others and not the shareholders and the shareholders lawfully acquired the Yukos shares.

Comment

It follows from the judgment that the jurisdiction of the tribunal in the case by the shareholders against Russia under Article 26 of the ECT remains a controversial issue. After all, the District Court in The Hague had ruled that there was no valid arbitration agreement as provisional application of the ECT only applied to ECT provisions that were not incompatible with Russian law. However, the Appeal Court in The Hague considered that provisional application of any provision of the ECT depended on whether such provisional application itself would be inconsistent with a rule of Russian law, which it found not to be the case. In any event, the Court of Appeal also found that Russia's legislation did enable international arbitration of investment disputes.

In addition, the judgment shows that, under Dutch arbitration law, even if an arbitral tribunal asserted an incorrect ground for its jurisdiction, this may be repaired in state court proceedings if it is held that there is another ground for jurisdiction of the tribunal, so that the award cannot be set aside on that basis.

Moreover, the Court of Appeal's approach on the dismissal of the "unclean hands" argument seems inconsistent with a fairly recent judgment by the same court in which it ruled that the prohibition of corruption overrules any procedural restrictions giving effect to an arbitral award that is asserted to be obtained on that basis (see [Legal update, Dutch court sets aside ICC award holding that underlying agreement was influenced by corruption \(Court of Appeal in The Hague\)](#)).

Russia has announced that it is to file an appeal with the Dutch Supreme Court and the outcome of that appeal will be eagerly anticipated by the international arbitration community.

Case

Hulley and others v Russian Federation (ECLI:NL:GHDHA:2020:234) (18 February 2020).

END OF DOCUMENT

Related Content

Topics

[UNCITRAL](#)

[Investment Treaty Arbitration](#)

[Energy arbitration](#)

Practice note: overview

[Investment arbitration under the Energy Charter Treaty](#) • [Maintained](#)

Practice notes

[Arbitrating under the UNCITRAL Rules 1976: a step-by-step guide](#) • [Maintained](#)

[Expropriation in international investment law](#) • [Maintained](#)

Checklists

[UNCITRAL arbitration \(1976 Rules\): flowchart](#) • [Maintained](#)

Legal updates

[Yukos interim awards published](#) • [Published on 03-Feb-2010](#)

Legal update: case report

[Majority shareholders in Yukos awarded US\\$50 billion](#) • [Published on 30-Jul-2014](#)

[The setting aside of the Yukos awards: full update](#) • [Published on 27-Apr-2016](#)

Glossary

[Energy Charter Treaty \(ECT\)](#) • [Maintained](#)

[Investor-State Dispute Settlement \(ISDS\)](#) • [Maintained](#)

Toolkit

[Practical Law Arbitration resources on developments arising out of Yukos awards](#) • [Maintained](#)

[UNCITRAL arbitration toolkit](#) • [Maintained](#)

Legislation tracker

[Practical Law Arbitration: What to expect: tracker](#) • [Maintained](#)