Court allows Russia's unclean hands argument against former Yukos shareholders (Court of Appeal in The Hague)

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In *Hulley and others v Russian Federation (ECLI:NL:GHDHA:2018:2476)*, the Court of Appeal in The Hague dismissed in an interim decision most of the procedural objections by former Yukos shareholders to certain of Russia's arguments, including its unclean hands arguments.

Speedread

In an interim judgment regarding an appeal brought by former Yukos shareholders against Russia, the Court of Appeal in The Hague has addressed the admissibility of certain of Russia's arguments. It has found in Russia's favour in respect of its unclean hands arguments and its arguments on the interpretation of the Energy Charter Treaty (ECT), but has honoured the shareholders' objections in respect of Russia's assertions on fraud committed by the shareholders in the arbitration.

In April 2016, the District Court in The Hague set aside arbitral awards that ordered Russia to pay around USD 50 billion to former Yukos shareholders, due to the absence of a valid arbitration agreement.

In the appeal proceedings brought by the shareholders, the shareholders applied to disregard certain assertions by Russia regarding its "unclean hands" defence (that the shareholders acted inappropriately when making their investments in Yukos), and regarding Russia's allegations of fraud committed by the shareholders and the interpretation of provisions of the ECT.

The Court of Appeal ruled that Russia timely invoked the "unclean hands" argument in the arbitration and that after the initial summons, Russia was allowed to provide a further legal or factual substantiation of the absence of a valid arbitration agreement as a ground for setting aside the awards, by raising the unclean hands argument. Further, the principle of due process was not violated by the introduction of the unclean hands argument. The court dismissed the argument that Russia would have waived or forfeited its right to invoke the unclean hands argument.

However, the court honoured the shareholders' objections with regard to Russia's assertions on fraud committed by the shareholders in the arbitration. Russia's arguments could at most qualify as a ground to revoke the awards, for which a separate procedure would have applied, so that these arguments could not be raised in these setting aside proceedings.

Lastly, the court dismissed the objections by the shareholders to disregard Russia's arguments on the interpretation of the ECT, as Russia had timely raised these assertions. The appeal is expected to be heard by the summer of 2019.

This decision confirms that a party requesting to set aside an arbitral award has a certain flexibility to substantiate the grounds for the setting aside, as included in the summons, later in the proceedings. (*Hulley and others v Russian Federation (ECLI:NL:GHDHA:2018:2476) (25 September 2018).*)

Background

Under the law applicable to arbitrations in the Netherlands, Article 1052 section 2 of the *Dutch Civil Procedural Code* (*Wetboek van Burgerlijke Rechtsvordering*) (the Code) as in force until 1 January 2015 (on which date the Dutch arbitration law has been changed; further references to the Code refer to the version in force until 1 January 2015) provides that a party who appeared in the arbitral proceedings must raise a plea that the arbitral tribunal lacks jurisdiction because of the absence of a valid arbitration agreement before submitting a defence. If they do not do so, that party may not raise such plea later in the arbitration or in state court proceedings, unless the plea concerns the lack of arbitrability.

Article 1065, section 2 of the Code confirms that an arbitral award cannot be set aside because of the absence of a valid arbitration agreement if a plea to that effect is not raised in the arbitration before a defence is submitted.

Pursuant to Article 1064, section 5 of the Code, all grounds for setting aside an arbitral award must be included in the summons of the setting aside proceedings. Under the old arbitration act, the District Court has jurisdiction to hear a setting aside claim in first instance.

In case of fraud, forgery or concealing relevant documents during the arbitration, an award can be revoked pursuant to Article 1068 of the Code. The claim for revocation must be brought before the Court of Appeal in first instance, no later than three months after discovery.

Facts

Hulley, Veteran Petroleum Limited and Yukos Universal Limited were shareholders of Yukos (the shareholders). In 2004, they initiated arbitration proceedings against Russia in The Hague based on the *Energy Charter Treaty (ECT)* (as in force at that time). The shareholders claimed that Russia expropriated their investments in Yukos and failed to protect these investments. The tribunal issued three interim awards on jurisdiction and admissibility, dismissing several jurisdiction and admissibility claims in 2009. In July 2014, in three final awards, the tribunal dismissed the remaining jurisdiction and admissibility pleas of Russia and ruled that Russia had violated the ECT, ordering it to pay damages of around USD 50 billion to the shareholders.

In November 2014, Russia summoned the shareholders in setting aside proceedings of the interim and final awards. In April 2016, the District Court in The Hague set aside the awards due to the absence of a valid arbitration agreement *Russian Federation v Veteran Petroleum Limited, Yukos Universal Limited and Hulley Enterprises Limited (ECLI:NL:RBDHA:2016:4230) (20 April 2016)* (see *Legal update, Hague District Court sets aside US$50 billion Yukos award)*. The shareholders appealed this decision.

In the appeal proceedings, the shareholders filed a motion to disregard certain assertions of Russia regarding its "unclean hands" defence, fraud committed by the shareholders in the arbitration and the interpretation of certain provisions of the ECT. The shareholders argued:

- With regard to the unclean hands argument, that Russia failed to invoke this argument timely in the arbitration and therefore, could no longer dispute jurisdiction on this basis.
- As the tribunal expressly dismissed the unclean hands argument in its award, Russia should have included its objections thereto in the setting aside summons and not as late as in its statement of reply in first instance of the setting aside proceedings.
- That the introduction of the unclean hands argument in the setting aside proceedings violated the principle of due process, as, amongst others, the amendment of claim to that effect was unacceptably late, while allowing the unclean hands argument would lead to a substantial delay of the proceedings.
- That Russia had waived or forfeited its right to raise the unclean hands argument.

Additionally, the shareholders raised objections to assertions by Russia concerning fraud committed by the shareholders in the arbitration. For instance, Russia argued that the awards would be in violation of the public order, as the shareholders submitted fraudulent statements and withheld documents in the arbitration, thus also violating a procedural order by the arbitrators.

Lastly, the shareholders requested the court to disregard Russia's statements on the interpretation of the ECT, being that the shares of the shareholders do not qualify as investments and that the shareholders and their founders do not qualify as (foreign) investors within the meaning of Article 1 sections 6 and 7 of the ECT, for instance because Russia would have failed to include these arguments in the setting aside summons.

Decision

In its interim judgment the Court of Appeal in The Hague rejected most of the shareholders' motion. It ruled that Russia was allowed to invoke the unclean hands argument to the effect that the shareholders acted inappropriately when making or when consolidating their investments in Yukos. However, the court ruled that Russia could not invoke fraud committed by the shareholders in the arbitration in these setting aside proceedings. Lastly, the court dismissed the objections to Russia's statements on the interpretation of the ECT.

As to the alleged failure to invoke the unclean hands argument in a timely manner, the court ruled that Russia had invoked the absence of a valid arbitration agreement in the arbitration before submitting its defence. Russia further substantiated this plea with the unclean hands argument later in the arbitration proceedings. Accordingly, the court ruled that Russia timely invoked the unclean hands argument in the arbitration, even though Russia raised this argument in the context of inadmissibility first and only later to dispute jurisdiction.

As to the argument that Russia should have included its objections in the setting aside summons, the court concluded that Russia had invoked the absence of a valid arbitration agreement in the setting aside summons, so that it was in principle allowed to provide a further legal or factual substantiation thereof at a later stage by raising the unclean hands argument.

As to the violation of the principle of due process, the court ruled that, as Russia introduced the unclean hands argument in its statement of reply in first instance, while the shareholders did not object thereto at that time, an objection thereto could not be invoked in appeal for the first time. Moreover, the shareholders had, in fact, responded to the unclean hands argument in first instance and in the appeal. According to the court, any related delay in

the proceedings was justified in light of the financial interests and complexity of the case. The court ruled that the principle of due process has not been violated.

The court also dismissed the argument by the shareholders that Russia had waived or forfeited its right to invoke the unclean hands argument, as Russia had not waived this argument explicitly, and the shareholders could not have reasonably assumed that to be the case.

Regarding the shareholders' objections to Russia's arguments on the fraud assertions, the court ruled that these arguments, at most, made out a case for revocation of the award. Revocation proceedings and setting aside proceedings are not the same, because revocation proceedings should be brought within three months after the fraud has become known and before the Court of Appeal in first instance. Such requirements do not apply to setting aside proceedings, and therefore, the court ruled that Russia could not invoke fraud in the setting aside proceedings, thereby honouring the objections of the shareholders on this point.

On the interpretation of the ECT, the court dismissed the objections by the shareholders, as it found that Russia had opposed the order of the tribunal with regard to its jurisdiction and the interpretation of Article 1 sections 6 and 7 of the ECT in the setting aside summons. Further, Russia had also argued that the investments by the shareholders would not qualify as foreign investments, but as Russian investments considering the origin of the funds invested, so that there would be no investments or investors within the meaning of the ECT.

The court reserved its decision on the appeal brought by the shareholders until after further written exchanges and a hearing expected to take place in the summer of 2019.

Comment

The decision by the Court of Appeal in The Hague is not only relevant because of the interests at stake in the underlying case, but also because the decision makes clear that, if a party invokes the absence of a valid arbitration agreement before submitting a statement of defence in the arbitration, that party may further substantiate this plea in the course of the arbitration. Further, the decision confirms that a party requesting to set aside an arbitral award has a certain flexibility to substantiate the grounds for the setting aside as included in the summons later in the proceedings. Lastly, the decision holds that, under Dutch arbitration law, grounds to revoke an arbitral award, such as fraud committed in the arbitration, can only be brought in separate proceedings before the Court of Appeal in first instance, and can in principle not be invoked in setting aside proceedings, even if they also qualify as a violation of public policy.

Case

Hulley and others v Russian Federation (ECLI:NL:GHDHA:2018:2476) (25 September 2018).

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