The European Arbitration Review

2021

Ukraine

The European Arbitration Review

2021

The European Arbitration Review, across 15 chapters, and 97 pages, is part invaluable retrospective and part primer on the characteristics of different seats, with a little crystal-ball gazing thrown in for good measure. All contributors are vetted for their standing and knowledge before being invited to take part.

Together, they capture and interpret the most substantial recent international arbitration events of the year just gone, with footnotes and statistics. This edition covers Austria, Finland, France, Italy, the Netherlands, Norway, Portugal, Russia, Spain, Sweden and Ukraine, and has overviews on econometrics; the direction of travel for construction disputes in Europe; and on the use (and non-use) of multiples for valuating things in investment treaty disputes, among other topics.

Ukraine

Oleh Marchenko
Marchenko Partners

Summary

IN SUMMARY
DISCUSSION POINTS
REFERENCED IN THIS ARTICLE
EVEREST ESTATE AND OTHERS V THE RUSSIAN FEDERATION
EXECUTION AGAINST PROPERTIES OF SOES – ALTER EGO THEORY
BANCEC – US SUPREME COURT
FUNNEKOTTER AND OTHERS V ZIMBABWE (DUTCH FARMERS)
ANATOLIE STATI AND OTHERS V KAZAKHSTAN
RUSSIAN SOES – PIERCING THE CORPORATE VEIL
CONCLUSION
ENDNOTES

IN SUMMARY

This chapter discusses the issues of execution immunity and collection against the sovereign assets of the Russian Federation and its state-owned enterprises in light of the ongoing investor–state cases against Russia pursued by Ukrainian investors seeking justice for the expropriation of their investments in the occupied territories of Crimea and Donbas.

DISCUSSION POINTS

- Collection against the assets directly owned by Russia will be a mission impossible in most cases – most of such assets are protected by execution immunity under treaties and customary international law.
- Ukrainian investors, instead, shall target overseas commercial assets of Gazprom, Sberbank, and other Russian SOEs, arguing that they are tightly controlled by Russia and are a mere extension of the Russian state.
- Municipal courts in both common law states and civil law states are increasingly willing to pierce the corporate veil of SOEs permitting private creditors to collect on their arbitral awards against non-performing states.

REFERENCED IN THIS ARTICLE

- *Everest Estate LLC and Others v The Russian Federation*, PCA Case No. 2015-36
- *Bancec Case – City Bank v Bancec* (US Supreme Court)
- *Anatolie Stati and Others v Kazakhstan*, SCC Case No. V 116/2010
- *Funnekotter and Others v Republic of Zimbabwe*, ICSID Case No. ARB/05/6

With a growing number of multimillion and multibillion arbitral awards against the Russian Federation for the expropriation of investments of Ukrainian nationals in annexed Crimea, the victorious investors will soon have to enforce these awards against sovereign assets of the Russian Federation worldwide and will test the issue of sovereign immunity in the municipal courts of forum states where the Russian Federation, its agencies and state-owned enterprises (SOEs) may have assets.

The Russian Federation proclaimed that it would not comply with such arbitral awards. Moreover, their enforcement in its home territory is not realistic, since the Kremlin controls Russian courts. Therefore, investors will have to consider enforcement actions against the Russian state's sovereign properties abroad. Collection against properties that are directly owned by Russia will be a mission impossible in most cases,[1] since outside its borders Russia holds properties valued at a few billion US dollars. Most of these assets are the property of Russian diplomatic missions and other state assets that are subject to execution immunity under both treaties and customary international law. Russia may also directly own commercial assets in other states for a few hundred million US dollars, which is insufficient to enforce competing claims against the state for billions of US dollars.[2] Deprived Ukrainian investors and other private creditors have much better chances of enforcing their claims

against Russia by targeting overseas commercial assets of Gazprom, Sberbank and other Russian SOEs.

EVEREST ESTATE AND OTHERS V THE RUSSIAN FEDERATION

Ukraine is a jurisdiction worth considering for enforcing arbitral awards against Russia. In*Everest Estate and Others v The Russian Federation,* 18 Ukrainian investors pursued enforcement actions in Ukraine to collect against Russian state-owned banks. The investors sought to attach the shares of Prominvestbank, VTB Bank and Sberbank – Ukrainian subsidiaries of three Russian state-owned banks (VEB, Bank VTB and Sberbank Russia). The investors sought the attachments to secure the enforcement of US$130 million (plus costs and interest) awarded by the PCA Tribunal on 2 May 2018 against Russia to compensate the investors for the illegal taking of their investments in Crimea after Russia annexed Crimea in 2014.[3]

After the Appeal Court of Kiev City attached the shares of Prominvestbank, VTB Bank and Sberbank on 5 September 2018,[4] accepting investors' arguments that the Russian Federation owned the attachable shares through state-owned Russian banks – VEB, Bank VTB and Sberbank Russia – the matter came under review on appeal by the Supreme Court of Ukraine and was decided on 25 January 2019.[5]

The Russian Federation chose not to participate in court proceedings in Ukraine. However, in a letter from the Ministry of Justice dated 8 November 2018, the Russian Federation proclaimed that it does not recognise the jurisdiction of the PCA Tribunal in ***Everest Estate*** established under the Russia–Ukraine BIT,[6] or the arbitral award dated 2 May 2018. Russia also proclaimed that all properties of the Russian Federation situated in Ukraine are subject to sovereign immunity. Therefore, the Supreme Court first considered the immunity defence raised by Russia. The Supreme Court decided that by providing its consent to an investor-state arbitration pursuant to article 9.2 of the Russia–Ukraine BIT, and by undertaking to execute arbitral awards pursuant to article 9.3 of the Russia-Ukraine BIT, the Russian Federation waived both jurisdictional and execution immunities:

> 78. Therefore, by including into [the Russia-Ukraine BIT] the arbitration clause, and by providing that arbitral awards shall be final and binding upon both parties to [investor-state] disputes, arising under [the Ukraine–Russia BIT] [as well as by undertaking to execute such arbitral award], the debtor – the Russian Federation, ipso facto, provided its consent to waive all types of sovereign immunity … [including]: a) immunity of foreign states from any court action [jurisdictional immunity], b) immunity from pre-judgment injunctions [such as assets attachment to secure future enforcement of arbitral awards], and c) immunity from execution.

In ***Everest Estate***, similar to the court practice in France, Switzerland and some other states,[7] the Supreme Court of Ukraine has applied the restrictive immunity theory both to jurisdictional immunity and execution immunity, holding that by providing its consent to arbitration under the Russia–Ukraine BIT, the Russian Federation waived all types of sovereign immunities, including immunity from execution. State practice nowadays widely recognises that waivers of sovereign immunity from jurisdiction may be implied from a consent to arbitrate,[8] but an express waiver is usually required for state immunity from execution.[9] However, over the past few decades, state practice has shifted to a greater application of the restrictive immunity theory to state immunity from execution. For example, although state practice is not uniform and may differ in details, the United States, the

United Kingdom, the Netherlands, Sweden and many other states permit creditors to execute arbitral awards against sovereign assets used in commercial activities (acts jure gestionis), as opposed to their use in government activities (acts jure imperii).[10] In ***Everest Estate***, the Supreme Court of Ukraine made an essential contribution to expanding the restrictive immunity theory to execution.

However, although the Supreme Court of Ukraine held in ***Everest Estate*** that the Russian Federation waived its immunity from execution, it is highly unlikely that the claimants will be able to collect through the forced sale of properties directly owned by the Russian Federation in Ukraine and used to perform government functions, such as the properties of the Russian Embassy in Ukraine. Such assets are subject to a special immunity regime under customary international law and the Vienna Convention on Diplomatic Relations. In ***Everest Estate***, the investors, therefore, tried to attach the shares (commercial assets) in Prominvestbank, VTB Bank and Sberbank, arguing that they are 'owned' by the Russian Federation (the debtor) indirectly through other state-owned Russian banks: VEB, Bank VTB and Sberbank Russia. The claimants argued that these state-owned banks are not institutionally or operationally independent of the Russian Federation, but acting merely as instrumentalities or agents of the Kremlin and, as a result, shall be liable for the debts of the Russian Federation.[11]

While addressing the appeal made by VEB, Bank VTB and Sberbank Russia that, under Russian law, they have separate legal personalities, they own the attachable shares in Prominvestbank, VTB Bank and Sberbank (not the Russian Federation), and, as separate legal entities, are not responsible for the debts owed by the Russian Federation, the Supreme Court of Ukraine observed that the Civil Code of the Russian Federation allows exceptions to the general rule of separate legal personality.[12] However, since the Appeal Court of Kiev City ordered to attach the shares of Prominvestbank, VTB Bank and Sberbank owned respectively by VEB, Bank VTB and Sberbank Russia (not by the Russian Federation), since the claimants did not provide evidence that VEB, Bank VTB and Sberbank Russia are not independent of the Russian Federation or acting as its alter egos so that their properties (including the attachable shares) could be treated as owned by the Russian Federation,and, instead, they asked the Appeal Court to attach the shares owned by VEB, Bank VTB and Sberbank Russia (not by the Russian Federation), the Supreme Court had no other choice but to hold that attachment and execution may be made only against those properties situated in Ukraine that are owned by the Russian Federation, and those properties owned by other persons may not be attached.[13]

The Supreme Court observed that executors should decide on a case-by-case basis whether any specific property is owned by the Russian Federation and, therefore, may be subject to attachment and execution in satisfaction of an arbitral award.[14]

By amending the Ruling of the Appeal Court and ordering to attach any shares of Prominvestbank, VTB Bank and Sberbank – which are owned by the debtor, the Russian Federation – the Supreme Court apparently left unanswered and open the issue of whether VEB, Bank VTB and Sberbank Russia may be treated as alter egos of the Russian Federation so that the commercial assets owned by these banks in Ukraine (including the shares in Prominvestbank, VTB Bank and Sberbank) may be treated as owned by Russia and, therefore, may be subject to attachment and execution.

EXECUTION AGAINST PROPERTIES OF SOES – ALTER EGO THEORY

It will be instructive to examine court practice related to the collection of claims against states through enforcement against commercial properties of SOEs in several common law and civil law jurisdictions, such as the Netherlands and the United States. Such court practice invariably involves piercing the corporate veil of SOEs on the grounds that SOEs:

- are owned and tightly controlled by a state; or
- are established by a state with the purpose (at least partial) to shield a state's commercial assets from its creditors and, therefore, respecting a separate corporate status of SOEs would serve injustice by permitting any non-performing state to avoid its responsibility for illegal takings or other internationally wrongful acts.

BANCEC – US SUPREME COURT

Bancec[15] is the leading US Supreme Court case on piercing the corporate veil of SOEs (instrumentalities) for a creditor of a state to reach its commercial assets, which are not protected by sovereign immunity from jurisdiction in the United States.

In ***Bancec***, the US Supreme Court allowed First National City Bank (Citibank) to recover assets from state-owned Banco Para El Comercio de Cuba (***Bancec***) (Cuba) to satisfy the petitioner's claims against Cuba for the illegal taking by Fidel Castro of the petitioner's investments (its banking branches) located in Cuba.

In September 1960, ***Bancec*** sought to collect on a letter of credit issued by First National City Bank (Citibank) in its favour in support of a contract for the delivery of Cuban sugar to a US buyer. Shortly after Citibank received from ***Bancec*** the request for collection on the letter of credit, its assets in Cuba were seized and nationalised without compensation. When ***Bancec*** brought a suit against Citibank on the letter of credit in the US District Court, Citibank counterclaimed, asserting a right to set off the value of its seized assets in Cuba. In ***Bancec***, the US Supreme Court considered the question of whether Citibank is entitled to set off its claims to Cuba against ***Bancec***'s letter of credit claims to Citibank, taking into account that ***Bancec*** was established by the government of Cuba as a separate juridical entity.

The US Supreme Court held that while there exists a strong presumption that government instrumentalities have a separate legal identity (along with limited liability) from their parent governments, this presumption can be overcome in situations:

> where a corporate entity [in this case, Bancec] is so extensively controlled by its owner [in this case, the government of Cuba] that a relationship of principal and agent is created, we have held that one may be held liable for the actions of the other. … In addition, our cases have long recognized 'the broader equitable principle that the doctrine of corporate entity, recognized generally and for most purposes, will not be regarded when to do so would work fraud or injustice.'

Applying 'principles of equity common to international law and federal common law', the US Supreme Court treated ***Bancec*** as an alter ego of the Cuban government, disregarding its corporate identity, and permitted Citibank to set off, observing that:

> [g]iving effect to Bancec's separate juridical status in these circumstances … would permit the real beneficiary of such an action, the Government of the Republic of Cuba, to obtain relief in our courts [by collecting on the letter of credit through Bancec] that it could not obtain in its own right without waiving its sovereign immunity and answering for the seizure of Citibank's assets – a

> seizure previously held by the Court of Appeals to have violated international law. We decline to adhere blindly to the corporate form where doing so would cause such an injustice.

Ukrainian nationals, whose investments were illegally expropriated by the Russian Federation or its proxies in annexed Crimea and occupied Donbas and who have debts to Russian state-owned banks (Sberbank, VTB Bank, Prominvestbank), using ***Bancec***'s logic and arguments, may consider bringing counterclaims in Ukrainian courts against court actions of the Russian banks seeking to enforce debt claims. The deprived investors may argue that these banks are alter egos of the Russian Federation, that these banks may not rely on their separate legal identity (and separate liability), and, as a result, the investors have the right to set off their expropriation claims to the Russian Federation against debts owed to the Russian banks. Since Ukraine is a civil law jurisdiction, its law does not have the common law doctrine of piercing the corporate veil. However, the same result may be reached through the application by Ukrainian courts of civil law concepts prohibiting the exercise of civil rights with the purpose to cause harm to others and prohibiting any other abuses of civil rights. Such an application of civil law concepts to deny separate juridical personality to a Kazakhstani state-owned sovereign wealth fund by a civil law state, the Netherlands, will be reviewed in *Anatolie Stati and Others v* Kazakhstan.

FUNNEKOTTER AND OTHERS V ZIMBABWE (DUTCH FARMERS)

In *Funnekotter and Others v Zimbabwe*,[16] Funnekotter and other dispossessed Dutch farmers obtained and registered in the United States an ICSID arbitral award against Zimbabwe for the uncompensated taking of their farms and land by the government of Robert Mugabe. They recently applied to the US District Court for the Southern District of New York, and were granted a declaratory judgment by the court stating that:

- four state-owned respondent companies that had been named on the US sanctions list[17] as Specially Designated Nationals (SDN)[18] are alter egos of Zimbabwe; and
- that they (the creditors) are entitled to seize the frozen assets of those alter egos, which the court declared to be in commercial use.[19]

In Funnekotter, each of the four targeted Zimbabwe's SOEs 'were classified as SDNs (Specially Designated Nationals) by The Office of Foreign Assets Control (OFAC), which, as the Court previously found, is 'one kind of (potentially very persuasive) evidence tending to show alter ego status'.[20] The court held that the 'Plaintiffs [Funnekotter and Others] were also entitled to 'an adverse inference about the contents' of board resolutions and minutes [of the SOEs] requested [through discovery] but not produced by [the defendants]'.[21] The District Court concluded that the defendant SOEs were alter egos of Zimbabwe:

> Zimbabwe's control over … each of the Defendants [SOEs] is so dominant that they and the sovereign [Zimbabwe] operated 'as a single enterprise.' Defendant ZMDC [Zimbabwe Mining Development Corporation] was structured to be dominated by Zimbabwe. The Zimbabwe Mining Development Corporation Act, which created ZMDC, mandates that Zimbabwe is to own no less than 51% of the entity's stock and that members of its board of directors – as well as the boards of directors of its subsidiaries – are to 'be appointed by the Minister after consultation with the President and in accordance with any directions the President may give him.' (Rule 56.1 Statement at ¶¶ 33-41; Jacob Decl. Exh. 12.) The Act also bars ZMDC from making any investments or loans without seeking the directions and advice of the Minister of Mines, who also

> sets the terms and conditions for the transfer of shares, approves auditors, and gives ZMDC's board of directors directions for managing [its] general reserve account. More generally, the Minister of Mines may direct ZMDC to take any actions that the Minister deems to be in the national interest, which ZMDC is responsible for promoting.[22]

As OFAC included the defendant state-owned banks in the SDN sanction list, it classified them as controlled by Zimbabwe and acting as its agents. The District Court fully relied on such classification by OPAC, holding that it was for the defendants to prove otherwise, and that because they failed to do so, the four state-owned banks under considerations shall be treated as alter egos of Zimbabwe:

> The Non-ZB Bank Defendants have offered no evidence of their independence whatsoever. As a result, they are far more analogous to the defendant in In re 650 Fifth Ave., No. 08 Civ. 10934, 2013 WL 2451067 (S.D.N.Y. June 6, 2013) than was ZB Bank. In In 650 Fifth Ave, Judge Forrest held that an OFAC designation [as Specially Designated Nationals] alone was sufficient for plaintiffs to meet their burden of showing that an entity is an instrumentality of a terrorist sponsor under the Terrorism Risk Insurance Act because the defendants, like the Non-ZB Bank Defendants here, presented no evidence tending to contradict OFAC's designation. Id.

> Agribank and Zimri's failure [both companies were sanctioned as SDNs by OFAC] to offer any evidence supporting independence from Zimbabwe has set the bar low for the Plaintiffs. Based on Agribank's and Zimri's designations as SDNs, this [District] Court concludes that the Agribank and Zimri were also so extensively controlled by Zimbabwe as to be its alter egos.[23]

The US District Court, therefore, granted a declaratory relief to the claimants that:

- the judgment against Zimbabwe may be enforced using the assets of the Non-ZB Bank Defendants located in the United States and used for commercial purposes, upon identification of such property; and
- the Non-ZB Bank Defendants' frozen assets in the United States are such property used for a commercial activity in the United States.

The Court granted the declaratory relief by reference to section 1610(b) of the Foreign Sovereign Immunities Act (FCIA) holding that:

> any property in the United States of an agency or instrumentality of a foreign state engaged in commercial activity in the United States shall not be immune from attachment in aid of execution, or from execution, upon a judgment entered by a court of the United States' if 'the judgment relates to a claim for which the agency or instrumentality is not immune by virtue of Section 1605(a)(2), (3), or (5) or 1605(b) of this chapter.' 28 U.S.C. § 1610 (2014). This Court has already held that the Non-ZB Bank Defendants, if [they are] found to be alter egos of Zimbabwe, are not immune from judgment under Section 1605(a)(2). ((See Jacob Decl. Exh. 3 at 4 (Feb. 10, 2011 Order)). Accordingly, Plaintiffs need only show that the Non-ZB Bank Defendants' assets are 'property in the United States of a foreign state … used for a commercial activity in the United States' before 'there can be post-judgment process' against the Non-ZB Bank Defendants' assets under the FSIA. See Aurelius Capital Partners, LP v. Republic of Argentina, No. 07 CIV. 11327 (TPG), 2010 WL 768874, at *2 (S.D.N.Y. Mar. 5, 2010).[24]

Soon after the declaratory relief for the execution on the US-sanctioned assets of Zimbabwe's SOEs, Zimbabwe and 18 Dutch farmers entered into a post-award settlement in June 2016 at ICSID's headquarters at the World Bank, according to which Zimbabwe agreed to pay the awarded amount to the Dutch farmers over several years.[25]

Funnekotter is important for enforcement and execution by Ukrainian nationals of arbitral awards against the commercial assets of Russian SOEs located in the US because the Russian Federation is a targeted sanctions country in the US, while many Russian state-owned and private companies are sanctioned in the United States as SDNs, including AB Rossiya, Almaz-Antey, Basic Element, Gazprom Burenie, Sberbank, Industrial Savings Bank, Renova, Rosoboronexport, Wagner and Gaz Group.[26] Moreover, SDN classification for US sanctions purposes may also serve as evidence of alter ego status for enforcement and execution in other jurisdictions.

ANATOLIE STATI AND OTHERS V KAZAKHSTAN

On 7 May 2019, the Amsterdam Court of Appeal issued a judgment upholding an earlier decision by the Amsterdam District Court allowing an attachment in favour of Anatolie Stati, Gabriel Stati, Ascom Group SA and Terra Raf Trans Trading Ltd, with respect to the Republic of Kazakhstan's shareholding in the Dutch entity KMG Kashagan BV held via the Kazakh sovereign wealth fund Samruk-Kazyna. Through its stake in Kashagan, which has a nominal value of approximately US$5.2 billion, Kazakhstan is participating in the international consortium relating to the Kashagan oilfield, one of the largest offshore oilfields in the Caspian Sea. Other members of the consortium include Eni, Royal Dutch Shell, Total, ExxonMobil, China National Petroleum Corporation and Inpex.[27]

In its judgment dismissing the appeals from Samruk and Kazakhstan, the Court of Appeal held that despite Samruk being a separate legal entity from Kazakhstan, it:

> lacks factual-economic independence [from Kazakhstan], in the sense that Samruk [as SOE] cannot invoke its legally separate nature vis-à-vis the Republic of Kazakhstan to formulate its own policies, deviating from the policies of (those politically responsible in) the Republic of Kazakhstan, and adopts the latter's policies [those of Kazakhstan] as its own. Based on this, in the absence of any other evidence, the court assumes that Samruk was founded by Kazakhstan with the purpose (at least in part) of keeping its assets out of reach of creditors of Kazakhstan.[28]

The Amsterdam Court of Appeal further held that 'regardless of the (formal) purpose' advanced behind incorporation of Samruk-Kazyna by Kazakhstan:

> Samruk in any event (also) functions as an instrument [of Kazakhstan] to shield a significant amount of the assets of the Republic of Kazakhstan from its creditors by means of Samruk holding shares in state participations [SOEs], which would, if Samruk were allowed to invoke its legally separate nature against a creditor of the Republic Kazakhstan, be out of reach for such a creditor, even though it is the Republic of Kazakhstan which (among other things) ultimately controls the assets of Samruk and the use which is made thereof [the assets of Samruk].[29]

In holding that Samruk shall be treated as an alter ego of Kazakhstan and shall be liable to Stati and others (as the creditors of Kazakhstan under the SCC arbitral award), the

Amsterdam Court of Appeal relied on the abuse of rights provisions contained in article 8 of the Civil Code of Kazakhstan, which require that civil rights be exercised 'in good faith, reasonably and fairly' and that any abuse of civil rights, including the exercise of civil rights to cause harm to others, is prohibited.[30]

The Amsterdam Court of Appeal also found that since the purpose of the attached shares was commercial in nature, Samruk was not entitled to rely on execution immunity.[31]

Moreover, Stati and others managed to secure multiple attachments before various courts in the Netherlands, Belgium, Sweden and Luxembourg of the properties of Kazakhstan worth around US$6 billion,[32] including the assets of the National Fund of Kazakhstan (cash, bonds and shareholdings worth US$530 million), which are managed by the Central Bank of Kazakhstan and held in custody by Belgium-incorporated Bank of New York Mellon (BONYM) at its branch in London (through courts in Belgium[33] and Luxembourg), US$100 million worth of shareholdings of Kazakhstan in 33 Swedish public companies (through courts in Sweden),[34] Kazakhstan's shareholding in Luxembourg-based Eurasian Resources Group and trade receivables owed to Kazakhstan from a number of companies in Luxembourg.[35]

The attachment decisions of various courts in ***Stati and Others v Kazakhstan*** are related to Anatolie Stati's and other investors' long-running battle to enforce the SCC award against Kazakhstan. Kazakhstan harassed Anatolie Stati, a national of Moldova, and other investors, and deprived them of their investments in oil fields in Kazakhstan. In December 2013, the SCC Tribunal held Kazakhstan liable for the breach of its fair and equitable treatment obligations under the Energy Treaty Charter and awarded the investors over US$500 million in damages, costs and interest. The award was upheld by the Swedish courts, including the Swedish Supreme Court.[36]

RUSSIAN SOES – PIERCING THE CORPORATE VEIL

The Russian Federation directly or indirectly owns controlling shares in major oil and gas companies, banks and other SOEs, such as Gazprom, Rosneft, Transneft and VEB.

Gazprom, Rosneft, Sberbank and other Russian SOEs are separate entities that are formally independent of the Russian government. However, digging into their connections may show that these SOEs often act as instruments of the Russian Federation and as extensions of it. The following factors may serve as evidence that Russian SOEs are alter egos of the Kremlin:

- economic control over SOEs;
- use of SOEs for political purposes;
- control over the decision-making of SOEs;
- SOEs as a state revenue source; and
- sanctions imposed by the US, the EU and other states over Russian SOEs for their engagement in the annexation of Crimea and occupation of Donbas by Russia.

The Russian Federation widely uses its SOEs as instruments of political influence. For example, Russia is notorious for using Gazprom, Rosneft and other SOEs in the energy sector as a weapon to advance its own political agenda and influence through manipulation in prices and threats to cut oil and gas supplies, therefore putting Kremlin's political interests over business.[37] Moreover, at home, Russian state-owned energy companies have to keep energy prices low, pursuing Russia's policy to sell gas and energy to domestic consumers at

below-market prices. The Kremlin does it at the expense and from the pockets of Gazprom and other SOEs, which are not compensated by Russia for subsidised domestic sales of energy sources within Russia.[38] Outside its borders, Russia may stop or suspend deliveries to those countries that refuse to support Kremlin's policies.[39]

The Kremlin has been using SOEs as instruments to pursue its foreign policies unrelated to commercial operations.[40] Rosneft operations in Venezuela is a clear example. Rosneft spent fortunes on various obviously loss-making undertakings in Venezuela to enable Russia to pursue its military and political agenda in Caracas.[41]

The Russian government maintains strong control over the management of major state-owned companies whose directors are accountable primarily to the Kremlin as their main shareholder. For example, although Gazprom has private shareholders, the majority of its shares are owned by Russia and most of its board of directors are pro-government Russian politicians who vote according to instructions from the Kremlin.[42] This is equally true for Gazprom and for other 'independent' SOEs in Russia that are often compared to two sides of the same rusty coin.[43]

The Russian Federation collects a large part of its public revenues through SOEs. Gazprom and other Russian SOEs are essential to public finances of the Russian Federation. For example, Gazprom alone contributes over 20 per cent to the state's public revenues and is often compared to a goose that lays golden eggs.[44]

Mineral Extraction Taxes account for the largest part of Russia's federal revenues, 43 per cent in 2010.[45] Facing state budget deficit, it was not uncommon for the Russian government to impose additional taxes on the industries where its SOEs operate. For example, at the end of 2015, as an ad hoc measure, the Kremlin imposed a 300 billion rouble tax hike on its oil and gas sector, of which Gazprom alone paid 100 billion roubles.[46]

State-owned energy holding Rosneftegaz was established by the Kremlin specifically to accumulate funds received as dividends from operational subsidiaries Rosneft and Gazprom.[47] Bypassing federal budget restrictions, these funds remain at the full disposal of the Kremlin to be used without any restriction or accountability for any purposes. Rosneftegaz is controlled by Rosneft's CEO, Igor Sechin, who chairs the board at Rosneftegaz. As with Sechin, the top management at Rosneftegaz comes from Rosneft. Rosneftegaz passes only a part of dividends it receives from Rosneft, Gazprom and other shareholdings to the federal budget, while most of these profits are retained by Rosneftegaz. President Vladimir Putin has expressly supported Mr Sechin's efforts to withhold profits retained by Rosneftegaz from the Russian budget and to use them to create a shadow budget outside public control. Answering questions from the public about funds accumulated by Rosneftegaz, he said:

> [the Russian government] will use Rosneftegaz funds for those matters, for which no money is available [in the federal treasury] after all bickering and wrangling, but which require funding.[48]

Deprived Ukrainian investors and other creditors of Russia may use the above and other considerations of Russia's control over its SOEs, a detailed discussion of which is outside the scope of this article, as evidence in municipal courts of any forum state that Russian SOEs are an integral part (an alter ego) of the Russian Federation.

CONCLUSION

After Ukrainian nationals have secured favourable arbitral awards against Russia for the illegal takings of their investments in the occupied territories of Ukraine, they will need to collect from Russia, while multiple obstacles will stand in their way. Russia declared that it would not comply with awards, and collection within Russia is not realistic, as Russian courts are controlled by the Kremlin. The investors may consider collecting against Russian sovereign properties outside its borders. However, Russia does not own directly significant properties in other states, and most of these sorts of properties are used for sovereign functions (acts jure imperii) (eg, the properties of Russian diplomatic missions), and are therefore protected by immunity from execution by creditors in most states. A more realistic option is to go against overseas commercial properties of Russian SOEs, such as Gazprom, Rosneft or Sberbank, claiming that Russian SOEs are the alter egos of Russia because they are tightly controlled by the Kremlin and are established with an abusive purpose (at least partial) to shield Russia's commercial assets out of reach by its creditors. As discussed, municipal courts in common law states, such as the United States, as well as in civil law states, such as the Netherlands, Luxembourg, Sweden and Belgium, are increasingly willing to pierce the corporate veil of SOEs permitting private creditors to collect on arbitral awards against non-performing states.

Despite many challenges that deprived Ukrainian investors and other creditors seeking to collect from the Russian Federation will be facing, they shall be able to succeed if they are committed and take all the right actions to force Russia to pay.

The author wishes to thank his colleague Anastasiia Kotliarchuk, an associate at Marchenko Partners, for her helpful research and assistance in preparing this article.

Endnotes

1 Obtaining an award in investor–state disputes against Russia is not even half of the road, as clearly illustrated by the saga of Franz Sedelmayer in ***Sedelmayer v Russia***-. The Russian president, Boris Yeltsin, ordered the illegal taking of investments of Franz Sedelmayer in Russia. He received an SCC arbitral award against Russia for US$2.35 million plus interest in 1998. It took Franz Sedelmayer over 12 years and over 30 execution cases to collect the major part of the award amount plus interest. He reportedly received US$6.8 million from the forced sale of an ex-KGB compound (which was converted into a commercial apartment complex) in Cologne, Germany, and the forced sale of Russian immovable properties in Sweden. ^ Back to section

2 After the US$50 billion PCA arbitral award against Russia in Yukos, the Russian Federation has been consistently pursuing a policy of owning, in other jurisdictions, only properties used for sovereign functions and, therefore, explicitly protected by execution immunity, such as properties of its diplomatic missions. Commercial operations and properties are usually pursued and owned by the Kremlin outside its borders through SOEs, such as Rosneft. As a result, commercial assets of the Russian Federation are effectively sheltered from its creditors. ^ Back to section

3 PCA press release. Arbitration Between Everest Estate LLC and Others as Claimants and the Russian Federation as Respondent. The Hague, 9 May 2018. http://www.pcacases.com/web/sendAttach/2325. ^ Back to section

4 *Everest Real Estate and Others v The Russian Federation*. The Ruling of the Appeal Court of Kyiv City (acting as a first instance court) dated 5 September, 2018, in Case No. 796/165/18 – http://reyestr.court.gov.ua/Review/76300778. Back to section

5 *Everest Estate and Others v The Russian Federation.* The Ruling of the Supreme Court of Ukraine, acting as an appeal court, dated 25 January 2019, in Case No. 796/165/18 – http://reyestr.court.gov.ua/Review/79573187. Back to section

6 Agreement Between the Government of the Russian Federation and the Cabinet of Ministers of Ukraine on the Encouragement and Mutual Protection of Investments (Moscow, 27 November 1998) (Russia–Ukraine BIT). Back to section

7 For example, in *Creighton Ltd v Minister of Finance of the State of Qatar* (the decision dated 6 July 2000), the French Court of Cassation permitted the execution of an ICC arbitral award against Qatar's assets in France pursuant to Qatar's implied waiver of immunity from execution: Back to section

8 Andrea K Bjorklund observes that it is presently widely, though not universally, accepted that a state's agreement to arbitrate in any forum state that is a party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, constitutes an implied waiver of state immunity from jurisdiction in enforcement actions. Moreover, the United Nations Convention on Jurisdictional Immunities of States and Their Property sets out that a written agreement to arbitrate constitutes a waiver of immunity in any court proceeding in support of arbitration, including enforcement measures, if an arbitration agreement relates to 'commercial transactions', which by definition include investment matters (article 17). Back to section

9 Andrea K Bjorklund observes that it has long been accepted by many states that a waiver of state immunity from jurisdiction (for example, under an arbitration clause in a bilateral investment treaty) does not encompass an automatic waiver of sovereign immunity from execution. Andrea K Bjorklund. ibid., pp. 1, 6. Back to section

10 Andrea K Bjorklund, ibid, pp. 1–2. Back to section

11 *Everest Estate and Others v The Russian Federation*. The Ruling of the Supreme Court of Ukraine, acting as an appeal court, dated 25 January 2019 in Case No. 796/165/18, Paragraphs 6, 24. Back to section

12 Ibid, paragraphs 89, 91. Back to section

13 Ibid, paragraph 122. Back to section

14 Ibid, paragraph 123. Back to section

15 *First National City Bank v Banco Para El Comerica Exterior de Cuba*, 462 U.S. 611, 626–28, 103 S. Ct. 2591, 2600-01, 77 L. Ed. 2d 46 (1983). Back to section

16 *Funnekotter and Others v Republic of Zimbabwe*. ICSID Case No. ARB/05/6. The award dated 22 April 2009. https://www.italaw.com/sites/default/files/case-documents/ita0349.pdf. Back to section

17 The Office of Foreign Assets Control (OFAC) in the US – together with authorities in Europe, Australia and elsewhere – froze assets belonging to a wide range of Zimbabwean ministers, state-owned entities, individuals and companies closely connected to abuses in Zimbabwe. Back to section

18 Specially Designated National (SDN) by OFAC – 'OFAC publishes a list of [sanctioned] individuals and companies owned or controlled by, or acting for or on behalf of, targeted countries', https://www.treasury.gov/resource-center/sanctions/SDN-List/Pages/default.aspx. Back to section

19 *Funnekotter v Agricultural Development Bank of Zimbabwe-* . No. 13 Civ. 1917 (CM) (SDNY 17 December 2015). https://casetext.com/case/funnekotter-v-agric-dev-bank-of-zimbabwe-2. Back to section

20 Ibid, paragraph 11. Back to section

21 Ibid, paragraph 11. Back to section

22 Ibid, paragraph 11. Back to section

23 Ibid, paragraph 13. Back to section

24 Ibid. Paragraph 14. Back to section

25 Lacey Yong, 'Zimbabwe is paying, reveals Dutch farmer', Global Arbitration Review, 10 October 2017. https://globalarbitrationreview.com/article/1148709/zimbabwe-is-paying-reveals-dutch-farmer. Back to section

26 SDN List Sorted by Country – https://www.treasury.gov/ofac/downloads/ctrylst.txt. Back to section

27 'Frozen Assets Securing a $532 Million Award Against Republic of Kazakhstan', Ascom Group News, 7 May, 2019. https://www.prnewswire.com/in/news-releases/dutch-court-upholds-5-2-billion-asset-freeze-on-major-kazakhstan-oil-field-896559853.html. Back to section

28 *Samruk-Kazyna and the Republic of Kazakhstan v Anatolie Stati and Others*. The Decision of the Amsterdam Court of Appeals in Case No. 200.234.096/01 KG dated 7 May, 2019, paragraph 3.10, https://jusmundi.com/en/document/decision/nl-ascom-group-s-a-anatolie-stati-gabriel-stati-and-terra-raf-trans-traiding-ltd-v-republic-of-kazakhstan-decision-of-amsterdam-court-of-appeal-tuesday-7th-may-2019#decision_5361. Back to section

29 Ibid, paragraph 3.10. Back to section

30 Ibid, paragraph 3.9. Back to section

31 Ibid, paragraph 3.11. Back to section

32 'Frozen Assets Securing a $532 Million Award Against Republic of Kazakhstan', Ascom Group News, 7 May 2019. Back to section

33 *The Republic of Kazakhstan v Stati and Others*. The Decision of the Dutch Speaking Court of First Instance of Brussels dated 25 May 2018 in Case No A.R. 2017/4282/A. http://res.cloudinary.com/lbresearch/image/upload/v1527690366/translation_final_english_order_of_25_may_2018_304118_1526.pdf. Back to section

34 *The Republic of Kazakhstan and the National Bank of Kazakhstan v Stati and Others*. Appeal Decision of Nacka District Court (Sweden) dated 5 July 2019. https://globalarbitrationreview.com/wps/forms/verify_digital_asset?asset_id=7e39cfa0-ba28-46a5-bcb1-b64cacf508d1. Back to section

35 'Stati v Kazakhstan: the winner takes it all?', ***Global Arbitration Review***, 11 July 2018. https://globalarbitrationreview.com/article/1171805/stati-v-kazakhstan-the-winner-takes-it-all. Back to section

36 'Frozen Assets Securing a $532 Million Award Against Republic of Kazakhstan', Ascom Group News, 7 May 2019. Back to section

37 Grigas, Is Russia's Energy Weapon Still Potent in the Era of Integrated Energy Markets? (Strategic Analysis November 2017). The European Centre of Excellence for Countering Hybrid Threats, 2017. Back to section

38 Dimo Bohme. EU-Russia Energy Relations: What Chance for Solutions? A Focus on the National Gas Sector. Universitatsverlag Potsdam 2011, p. 83. Back to section

39 Marshall I Goldman, ***Petrostate: Putin, Power, and the New Russia,*** Oxford University Press 2008, page 99. http://willzuzak.ca/cl/putin/Goldman2008PetrostatePutinPower.pdf. Back to section

40 Macey A Bos, Gazprom: Russia's Nationalized Political Weapon and the Implications for the European Union, Georgetown University Washington, DC 2012, https://repository.library.georgetown.edu/bitstream/handle/10822/557642/Bos_georgetown_0076M_11565.pdf;sequence=1. Back to section

41 Christian Lowe and Rinat Sagdiev, 'How Russia sank billions of dollars into Venezuelan quicksand, A Reuters Special Report', 14 March 2019. https://www.reuters.com/investigates/special-report/venezuela-russia-rosneft/. Back to section

42 Vavilov, A, Nicholls, D (2016), Gazprom: An energy giant and its challenges in Europe (2nd ed), Springer, 2016. Back to section

43 Kirill Shamiev, Lika Mchedlidze, Who Hold Leadership Roles in Russia's Government and State-Run Companies? Riddle, 7 December 2018, https://www.ridl.io/en/who-hold-leadership-roles-in-russias-government-and-state-run-companies/. Back to section

44 Vavilov, A, Nicholls, D (2016), Gazprom: An energy giant and its challenges in Europe (2nd ed), Springer, 2016, p. 49. Back to section

45 Federal Budget Revenue. Tax Statistics. Federal Tax Service of Russia. https://www.nalog.ru/eng/tax_statistics/rbr/. Back to section

46 Jason Concoran, 'Gazprom faces tax grab', ***Petroleum Economist***. 21 September 2018. https://www.petroleum-economist.com/articles/politics-economics/europe-eurasia/2018/gazprom-faces-tax-grab. Back to section

47 Rosneftegaz is an intermediary holding company wholly owned by the Russian Federation. Rosneftegaz owns 100 per cent shares in operational subsidiary Rosneft and 10.97 per cent shares in Gazprom. Back to section

48 Janis Kluge, 'Mounting Pressure on Russia's Government Budget. Financial and Political Risks of Stagnation', SWP Research Paper 2019/RP 02, February 2019. https://www.swp-berlin.org/10.18449/2019RP02/#hd-d58346e2934. Back to section

MARCHENKO
PARTNERS

Oleh Marchenko om@marchenkopartners.com

4-B, Ivana Franko Street, 1st Floor, Office 49, Kiev 01054, Ukraine

Tel: +380 44 220 0711

http://www.marchenkopartners.com/

Read more from this firm on GAR