



# The European Arbitration Review 2019

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Published by Global Arbitration Review in association with

Association for International Arbitration

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## **Protection of investments in international armed conflicts: a case for Donbas**

The illegal annexation of Crimea by the Russian Federation in April 2014, which was followed by the armed conflict in Donbas that has been financed, supported (through military, economic and political assistance) and de facto controlled by the Russian Federation, resulted in the large-scale expropriation, destruction, impairment and losses of investments in the occupied territories of Crimea and Donbas. This includes investments owned by both private and state-owned companies. According to the State Property Fund of Ukraine, over 900 state-owned companies, including Ukrainian Railways, Ukrainian Seaport Authority and Ukrainian Post, lost their investments in Crimea and Donbas. According to the report of the Atlantic Council (in the article ‘Kremlin Aggression in Ukraine: The Price Tag’) the material losses of Ukraine in Crimea and Donbas may amount to almost US\$100 billion.<sup>1</sup>

However, only a few private and state-owned companies pursued investor–state claims against the Russian Federation for expropriation of investments in Crimea. These include:

- *Everest Estate LLC and Others v Russia* (US\$150 million in damages and interest were awarded on 2 May 2018);<sup>2</sup>
- *PJSC CB PrivatBank and Finance Company Finilon LLC v Russia* and *Aeroporto Belbek LLC and Mr Igor Kolomoisky v Russia* (in the *PrivatBank* and *Belbek* cases, tribunals accepted jurisdiction in February 2017);<sup>3</sup>
- *PJSC Ukrnafta v Russia* and *Stabil LLC and Others v Russia* (in the *Ukrnafta* and *Stabil* cases, tribunals accepted jurisdiction in June 2017);<sup>4</sup> and
- *Oschadbank v Russia*, *Lugzor LLC and Others v Russia* and *PJSC DTEK Krymenergo v Russia*.

At the same time, no investor–state claims against Russia have so far been pursued in respect of occupied Donbas. Russia’s involvement and its effective control over Donbas is supported by abundant evidence, and, similarly to Crimean cases, the Russian Federation shall be responsible under international investment law for expropriation, destruction and other damages to investments in Donbas.

In this article, I will explore, among other matters, the grounds to hold the Russian Federation responsible under its own bilateral investment treaties (BITs), including the Russia–Ukraine BIT, for expropriation, destruction and failure to protect foreign investments during the armed conflict in the occupied territories of Donbas. Russia’s responsibility may be triggered by the effective control directly or indirectly exercised by Russia in Donbas.

## **Russia’s occupation**

The abundant evidence collected by the Ukrainian authorities and international organisations supports the view that the Russian

Federation has been in effective control over Donbas since 2014 and, therefore, shall be treated as an occupying power.

## **Effective control**

Article 42 of the 1907 Hague Regulations, the main legal authority for occupation, provides that ‘territory is considered occupied when it is actually placed under the authority [effective control] of the hostile army. The occupation extends only to the territory where such authority has been established and can be exercised.’<sup>5</sup>

As follows from article 42 and its application by the international tribunals and courts, such as International Court of Justice (ICJ) and the International Criminal Tribunal for the former Yugoslavia (ICTY), in cases concerning armed conflicts ‘occupation’ requires the de facto placement of a state’s territory or its part under the authority of a hostile army, which is exercised by the occupying power through effective control over the occupied territory. For example, in *Armed Activities on the Territory of the Congo (Democratic Republic of the Congo v Uganda)*, the ICJ examined whether Uganda occupied the Ituri district of Democratic Republic of the Congo over which the Uganda People’s Defence Forces exercised effective control:

*175. It is not disputed between the Parties that General Kazini, commander of the Ugandan forces in the DRC, created the new “province of Kibali-Ituri” in June 1999 and appointed Ms Adèle Lotsove as its Governor. Various sources of evidence attest to this fact, in particular a letter from General Kazini dated 18 June 1999, in which he appoints Ms Adèle Lotsove as “provisional Governor” and gives suggestions with regard to questions of administration of the new province. This is also supported by material from the Porter Commission. The Court further notes that the Sixth report of the Secretary-General on MONUC (S/2001/128 of 12 February 2001) states that, according to MONUC military observers, the UPDF was in effective control in Bunia (capital of Ituri district).<sup>6</sup>*

## **Overall control**

A classical case of occupation involves the physical presence of a hostile army of one state exercising authority (effective control) over the territory of another state without consent. However, in today’s armed conflicts, such as that in Donbas, it is usual for a foreign state to exercise its control over a given territory through the local military or paramilitary groups, which are trained, equipped, financed, generally supported and coordinated by the state. International tribunals and courts developed ‘overall control’ concept to attribute actions of local military groups to outside (foreign) state, which finances, supports and coordinates such groups.

For example, in the *Tadić* case, the ICTY applied the ‘overall control’ concept in order to establish that Serbia exercised sufficient control over the military forces operating in Bosnia and,

therefore, Serbia acting through its proxies was engaged in an international armed conflict in Bosnia.<sup>7</sup> In the *Blaškić* case, the ICTY also relied on the overall control concept to establish the existence of an indirect occupation:

*In relation to areas within Bosnia, Croatia played the role of occupying Power through the overall control it exercised over the HVO [the local militia, which destroyed the property of the Bosnian Muslims], the support it lent it and the close ties it maintained with it . . . the overall control exercised by Croatia over the HVO means that at the time of its destruction, the property of the Bosnian Muslims was under the control of Croatia and was in occupied territory.*<sup>8</sup>

According to the jurisprudence of the ICTY, in order to establish overall control over military or paramilitary groups and international responsibility for their actions, financial and military support and general coordination of military activities are sufficient:

*131. In order to attribute the acts of a military or paramilitary group to a State, it must be proved that the State wields overall control over the group, not only by equipping and financing the group, but also by coordinating or helping in the general planning of its military activity. Only then can the State be held internationally accountable for any misconduct of the group. However, it is not necessary that, in addition, the State should also issue, either to the head or to members of the group, instructions for the commission of specific acts contrary to international law.*<sup>9</sup>

In the *Bosnia Genocide* case, the ICJ rejected the ‘overall control’ test, as applied by the ICTY in the *Tadić* case, stating that this test provides for a wider scope of state responsibility for acts committed by others as reflected in article 8 of the ARSIWA.<sup>10</sup> In *Bosnia Genocide*, the ICJ followed its earlier *Nicaragua* case and applied the ‘effective control’ test, which requires a greater degree of control by a state over military or paramilitary groups operating outside its borders in order to attribute their wrongful acts to the controlling state and trigger its responsibility.<sup>11</sup>

While the ICJ used its own strict control test, the ICTY and others derogated from the ICJ cases. They applied less demanding control tests to ensure that states do not avoid responsibility for internationally wrongful acts when they act through others. As the Appeal Chamber of the ICTY stated in the *Tadić* case, the degree of control required for attribution and state responsibility may vary in different circumstances:

*The requirement of international law for the attribution to States of acts performed by private individuals is that the State exercises control over the individual. The degree of control may, however, vary according to the factual circumstances of each case. The Appeal Chamber fails to see why in each and every circumstance international law should require a high threshold for the test of control.*<sup>12</sup>

### European Court of Human Rights

The European Court of Human Rights (ECtHR) in its jurisprudence uses a similar and wider effective control tests to decide which state shall be responsible for violation of human rights on a given territory – the sovereign state deprived of effective control over its territory or the aggressor state which gained and exercises authority over such territory. Although the ECtHR does not employ territorial nexus, its jurisprudence sheds light on responsibility of states for activities of non-state actors outside their territories.

For example, in the *Loizidou v Turkey* case, the ECtHR attributed violations of human rights by the local authorities in northern Cyprus to Turkey because Turkey exercised its effective overall control over the whole area of northern Cyprus:

*It is not necessary to determine whether . . . Turkey actually exercises detailed control over the policies and actions of the authorities of the “TRNC” [Turkish Republic of Northern Cyprus]. It is obvious from the large number of [Turkish] troops engaged in active duties in northern Cyprus . . . that her army exercises effective overall control over that part of the island [northern Cyprus]. Such control . . . entails her responsibility for the policies and actions of the “TRNC.”*<sup>13</sup>

Likewise, in the *Cyprus v Turkey* case, the ECtHR used an effective overall control test to establish jurisdiction and responsibility of Turkey not only for the action of its military forces, but also for actions of the local administration in northern Cyprus:

*Having effective overall control over northern Cyprus, its [Turkey’s] responsibility cannot be confined to the acts of its own soldiers or officials in northern Cyprus but must be engaged by virtue of the acts of the local administration which survives by virtue of Turkish military and other support.*<sup>14</sup>

In *Ilascu and Others v Moldova*, the ECtHR ruled that the Russian Federation was responsible for human rights violations committed by the local authorities of the Moldovan Republic of Transnistria (MRT), a sovereign territory of Moldova under the effective authority of the local secessionist movement, which could not ‘survive’ without ‘the military, economic, financial and political support’ from the Russian Federation:

*All of the above proves that the “MRT”, set up in 1991–1992 with the support of the Russian Federation, vested with organs of power and its own administration, remains under the effective authority, or at the very least under the decisive influence, of the Russian Federation, and in any event that it survives by virtue of the military, economic, financial and political support given to it by the Russian Federation.*<sup>15</sup>

### Evidence

Considering the abundant evidence of Russia’s heavy involvement in the armed conflict in Donbas, one may infer that Russia shall be treated as an occupying power by reason of Russia’s effective control in Donbas, which is exercised directly (through Russian military personnel, de facto present in Donbas) or indirectly through overall control by Russia over the local anti-governmental forces. Evidence includes the following:

- Ukraine and its parliament regard the uncontrolled territories of Donbas as ‘temporarily occupied’ by the Russian Federation, as occupied by the ‘military forces of the Russian Federation’ and as under the ‘occupation administration of the Russian Federation’.<sup>16</sup>
- Ukraine asserts that it is in possession of plentiful evidence to prove that self-proclaimed bodies that usurped the exercise of power on the occupied territories of Donbas are controlled by Russia, that irregular illegal armed groups in Donbas have been created, subordinated, managed and funded by the Russian Federation.
- The Russian rouble was introduced as the single currency in the territory of certain districts of the Donetsk and Luhansk Regions.

- In addressing the issue of terrorism financing in the ICJ, Ukraine referred to the DPR (Donetsk People's Republic) and the LPR (Luhansk People's Republic) as 'proxies of the Russian Federation':

*The DPR and the LPR emerged as two of the primary illegal armed groups operating in Ukraine. These organizations and other groups and individuals associated with them are proxies of the Russian Federation: they operate with critical Russian support and assistance, defying Ukrainian and international law, committing acts of terrorism, and inflicting violence and human rights abuses on the people of Ukraine [in DPR and LPR].*<sup>17</sup>

- In addressing international crimes in the armed conflict in Donbas, the prosecutor of the International Criminal Court stated in its recent report:

*During the course of the conflict, periods of particularly intense battles were reported in Ilovaisk (Donetsk oblast) in August 2014 and in Debaltseve (Donetsk) from January to February 2015. The increased intensity of fighting during these periods has been attributed to alleged corresponding influxes of troops, vehicles and weaponry from the Russian Federation to reinforce the positions of the armed groups.*<sup>18</sup>

- The Parliamentary Assembly of the Council of Europe recognised the uncontrolled territories of Donbas as 'temporarily under the effective control of the Russian authorities.'<sup>19</sup>
- In the appeal to the international community, the Ukrainian parliament asserted the 'active support of terrorists at the state level' by Russia.<sup>20</sup>
- Ukraine filed two applications to the ECtHR – on the situation in Eastern Ukraine and Donbas before and after September 2014. Ukraine places responsibility on the Russian Federation for numerous violations of the European Convention on Human Rights as a result of 'de facto control over the regions of Donetsk and Luhansk' by the Russian Federation.<sup>21</sup>
- The Organization for Security and Co-operation in Europe monitoring mission reported the presence of troops naming themselves as Russian servicemen in the DPR-controlled territory.<sup>22</sup>
- The Atlantic Council reported that by July 2017, 36,300 Russian proxies and 2,900 Russian regular military personnel (from Kostroma, Novorossiysk and Volgograd Regions of Russia) were present in occupied Donbas. Russia supplied weapons and military equipment to the DPR and LPR, including Russian tanks, heavy artillery and multiple launch rocket systems, armored fighting vehicles and anti-aircraft warfare systems.<sup>23</sup>

Such combination of direct and indirect evidence demonstrates that, from the very start of the armed conflict in Donbas (eastern Ukraine) the Russian Federation has been exercising effective control over and is an occupying power in Donbas.

Even though it may be more difficult for investors to prove classic occupation of Donbas by Russia, there is abundant convincing evidence of indirect occupation of Donbas by Russia through the overall control over the local anti-government forces, including financial support, supply of weapons and military equipment, political support and coordination of military operations in the occupied territories.

### Application of Russia's BITs to occupied Donbas

BIT's territorial application: what is territory?

Assuming that Russia exercises effective control over Donbas directly (through its military personnel present in Donbas) or at least indirectly through the overall control exerted by Russia over the anti-government forces of the unrecognised DPR and LPR, I will now consider whether the territorial application of Russian BITs, including the Russia–Ukraine BIT, and whether the obligations of the Russian Federation to protect foreign investments in its territory shall be extended to occupied Donbas.

It will be instructive to review the Crimean cases in which arbitral tribunals have extended the territorial application of the Russia–Ukraine BIT to annexed Crimea.

For example, in *PJSC Ukrnafta v Russia* and *Stabil LLC and Others v Russia*, two identically constituted tribunals in jurisdictional rulings dated 26 June 2017, held that the Russia–Ukraine BIT applied to annexed Crimea and the Russian Federation was responsible for protection of the investments of the Ukrainian investors in Crimea after its annexation by Russia. Relying on Russia's own assertions that annexed Crimea was an integral part of Russia's territory and also relying on Ukraine's written submissions acknowledging that Crimea was under occupation and under effective control of the Russian Federation, the tribunals were satisfied that the Russian Federation established the effective control over Crimea through a combination of physical occupation of Crimea in February 2014 and legal incorporation of Crimea into the Russian Federation in March 2014. The arbitral tribunals did not consider the legality of Russia's occupation of Crimea.

In light of the object and purpose of the Russia–Ukraine BIT – to encourage and to protect foreign investments – the arbitral tribunals interpreted the term 'territory' in the Russia–Ukraine BIT broadly to cover the 'entire' territory over which the Russian Federation exercises its effective control (and its de facto jurisdiction), irrespective of whether such territory is lawfully or unlawfully occupied by the Russian Federation. The Russian Federation was able to exercise its de facto jurisdiction in Crimea and this alone was sufficient for Russia to be held responsible for protection of investments in Crimea under the Russia–Ukraine BIT.

The arbitral tribunals stated that the object and purpose of the Russia–Ukraine BIT do not permit a restrictive interpretation of the term 'territory' which 'would exclude investments that ended up being located on a contracting states territory as the result of that state's territorial expansion', irrespective of whether such expansion is lawful or unlawful. The arbitral tribunals reasoned in their rulings that it would be incompatible with the object and purpose of the Russia–Ukraine BIT:

*to leave without protection foreign investments on a territory over which a State exercises exclusive control [effective control] . . . particularly in circumstances where that State is not only the main beneficiary-State of these investments but also the only state in a position to protect foreign investments.*<sup>24</sup>

Because the Russian Federation exercises 'effective control' over Donbas, either directly or indirectly through overall control over the local anti-governmental authorities in DPR and LPR, the same reasoning may be invoked by foreign investors, including Ukrainian investors, to extend the application of Russia's BITs, including the Russia–Ukraine BIT, to occupied Donbas and to hold Russia responsible for expropriation and impairment of foreign investments in Donbas.

### Moving treaty-frontiers rule

Apart from broad application of the territorial scope of Russia's BITs to occupied Donbas based on broad interpretation of the term 'territory', investors may also consider an argument that the territorial application of Russia's BITs shall be extended to the newly acquired territories based on the moving treaty-frontiers rule.

The moving treaty-frontiers rule, which is a customary rule of public international law, is codified in article 29 of the Vienna Convention of the Law on Treaties (VCLT)<sup>25</sup> and in article 15 of the Vienna Convention on Succession of States in respect of Treaties (VCST).<sup>26</sup> Article 29 of the VCLT provides that treaties of a state shall apply to its 'entire territory' at any given time, while article 15 of the VCST extends the application of treaties of a state to newly acquired territories:

*When part of the territory of a State [Donbas, which is a part of Ukraine's territory] becomes part of the territory of another State [Russia as a result of its occupation of Donbas]:*

- (a) *treaties of the predecessor State [treaties of Ukraine] cease to be in force in respect of the territory [in respect of occupied Donbas] . . . from the date of the succession of States; and*
- (b) *treaties of the successor State [treaties of Russia] are in force in respect of the territory to which the succession of States relates [in respect of occupied Donbas] from the date of the succession of States, unless it appears from the treaty or is otherwise established that the application of the treaty to that territory would be incompatible with the object and purpose of the treaty or would radically change the conditions for its operation.*

However, extension of the application of Russia's BITs to occupied Donbas and its territory under article 15 of the VCST would seem to be precluded by article 6 of the VCST providing that the VCST:

*applies only to the effects of a succession of States occurring in conformity with international law and, in particular . . . the Charter of the United Nations [the UN Charter prohibits an illegal use of force, including illegal occupation by states of foreign territories].*

Richard Happ and Sebastian Wuschka in their recent article 'Horror Vacui: Or Why Investment Treaties Should Apply to Illegally Annexed Territories' have discussed that the non-recognition principle and the moving treaty-frontier rule should be applied in a way to deny benefits to Russia for the illegal annexation of Crimea. However, they should not excuse Russia from its obligations to protect foreign investments in annexed Crimea under Russia's BITs.<sup>27</sup> We agree with the approach and reasoning advanced by Mr Happ and Mr Wuschka. We believe that the same approach is equally applicable to occupied Donbas.

Under the non-recognition principle, the main reason for denying the recognition of title to illegally acquired territories, and to exclude state succession in respect of treaties in such cases, was to deprive states engaged in unlawful conduct violating territorial sovereignty of other states from any benefits and rights arising from their unlawful actions. However, it would be contrary to the very purpose of the non-recognition principle if this principle were applied the other way around to permit an occupying state to avoid international obligations and responsibility under its own treaties, including its international obligations to protect foreign investments pursuant to its BITs, in respect of any illegally occupied territories.

Therefore, the effect of Russia's BITs in occupied Donbas shall not be recognised in respect of any benefits and rights, which Russia may potentially claim in such case. For example, Russia shall not be permitted to claim that under its applicable BITs Russia is entitled to nationalise or expropriate foreign investments in occupied Donbas if such nationalisation or expropriation are made for public purpose and subject to prompt, adequate and effective compensation. However, it shall not release Russia from its obligations to protect foreign investments in occupied Donbas under Russia's BITs because Russia is the only state exercising effective control in Donbas and the only state, which has capacity to protect investments in Donbas.

Such application of Russia's BIT to occupied Donbas is supported in international jurisprudence. For example, the ICJ in its 1971 Namibia Advisory Opinion stated that South Africa remained responsible for any violation of its own international obligations in the occupied territory of Namibia, notwithstanding that South Africa had no title to the territory pursuant to the non-recognition principle. According to the ICJ, physical control exercised by South Africa over the occupied territory, not sovereignty or legitimacy of title, was the basis for its responsibility:

*118. South Africa, being responsible for having created and maintained a situation which the Court has found to have been validly declared illegal, has the obligation to put an end to it. It is therefore under obligation to withdraw its administration from the Territory of Namibia. By maintaining the present illegal situation, and occupying the Territory without title, South Africa incurs international responsibilities arising from a continuing violation of an international obligation. It [South Africa] also remains accountable for any violations of its international obligations [in occupied Territory of Namibia], or of the rights of the people of Namibia. The fact that South Africa no longer has any title to administer the Territory does not release it from its obligations and responsibilities under international law towards other States in respect of the exercise of its powers in relation to this Territory. Physical control of a territory, and not sovereignty or legitimacy of title, is the basis of State liability for acts affecting other States.<sup>28</sup>*

### Collective claims

Small- and mid-size private and state-owned companies that lost investments in Crimea and Donbas and otherwise would be precluded from pursuing investor-state claims against Russia because of significant financial costs involved may consider and follow the example of collective claims pursued in several Crimean cases:

- PrivatBank joined the efforts with Finance Company Finilon;<sup>29</sup>
- NJSC Naftogaz filed its claims together with PJSC Chornomornaftogaz, PJSC Ukrtransgaz, Subsidiary Company Likvo, PJSC Ukrgasvydobuvannya, PJSC Ukrtransnafta, and Subsidiary Company Gaz Ukrainy;<sup>30</sup>
- Stabil LLC, Rubenor LLC, Rustel LLC, Novel-Estate LLC, PII Kirovograd-Nafta LLC, Crimea-Petrol LLC, Pirsan LLC, Trade-Trust LLC, Elefteria LLC, VKF Satek LLC, and Stemv Group LLC jointly approached the Permanent Court of Arbitration on 15 June 2015 claiming an alleged expropriation of petrol stations by the Russian Federation in annexed Crimea;<sup>31</sup> and
- Everest Estate LLC was joined by 18 other legal entities.<sup>32</sup>

In *Everest Estate LLC and Others v Russia*, taking into consideration 'apparent lack of relationships' between the 19 claimants, the arbitral tribunal considered possible jurisdictional objections of the

Russian Federation against multiparty claims from allegedly unrelated claimants. The arbitral tribunal noted that the UNCITRAL Arbitration Rules did not expressly provided for collective claims. The arbitral tribunal stated that the Russia–Ukraine BIT used both ‘investor’ and ‘investors’ wording. The tribunal also relied on the *Abaclat and Ambiente Ufficio* cases to conclude that although the Russia–Ukraine BIT did not expressly provide for multiparty claims, it does not mean there was a lack of consent by Russia and the investors. The arbitral tribunal stated that ‘the state [the Russian Federation] and each investor [each of the 19 investors in the case in question] have given their consent’. Finally, the arbitral tribunal found ‘sufficient link’ among the claimants due to the jointly submitted claim, the application of the same legal provisions, the existence of ‘similar circumstances’ related to expropriation of their assets in Crimea and ‘substantially identical’ relief sought by each claimant.<sup>33</sup>

### Conclusion

Russia’s heavy involvement and its control over local anti-governmental groups in Eastern Ukraine are supported by abundant evidence, including the reported influx of Russian troops at some critical points in the armed conflict, continuous presence of Russian military personnel in Donbas, financial support, supply of weapons, political support and general coordination of military operation in Donbas by Russia. This convincingly demonstrate that the Russian Federation exercises effective control in occupied Donbas and shall be regarded as an occupying power. Therefore, similarly to the Crimean cases, foreign and Ukrainian investors acting individually or collectively may consider invoking Russia’s BITs to pursue investment claims against Russia and hold the Russia Federation responsible for expropriation of their investments in occupied Donbas.

*The author wishes to thank Professor Anthony Cassimatis for providing his valuable comments to this article. The author also wishes to thank his colleague Mariia Stolbova for research assistance and her helpful comments to this article.*

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MARCHENKO PARTNERS helps international and domestic clients to manage and resolve their vital regulatory and commercial issues and disputes at the crossing of national and international laws and policy matters. We specialise in antitrust and competition, arbitration and alternative dispute resolution, criminal defence, IP, life sciences, litigation and white-collar crime.

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