Fall 2007
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# Russia/Eurasia Committee

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Dear Russia/Eurasia Committee Members,

The Committee has enjoyed an active Fall.

In October, the Committee co-sponsored a Panel at the Section's Fall meeting in London entitled "They Came, They Saw, They Bought: Outbound Investments by Russian, Indian & Chinese Companies," moderated by former Committee Co-Chair Bruce Bean. This Panel was a sequel to a panel the Committee co-sponsored at the Spring Section meeting in Washington, D.C. comparing investment challenges in these same emerging markets from the perspective of in-house counsels to US companies in the countries.

Vice-Chair Franklin Gill has been busy this Fall working with Sergei Budylin (a Russian lawyer) and Olena Kibenko (a Ukrainian lawyer) on the Committee's submission to Year In Review, an annual publication by the Section early each year. Christopher Kelley, Committee Vice-Chair, has been assisting with the editing and coordinating the Ukrainian submission. The Committee's deadline for Year In Review is December 3.

Each month the Committee hosts a conference call on the third Thursday at 10 am EST. An agenda and dial-in details are distributed in advance, and I encourage you to join us and discuss topics of interest with your colleagues.

Finally, we are re-organizing and recruiting for the Steering Group for the Russia/Eurasia Committee. Please let me know if you are willing to work actively and contribute to the Committee in any of its dimensions: listserve discussion, program proposals, publications, newsletters, policy formulation and recommendation, membership, stand-alone programs, etc. The Steering Group is utilized as the management organ of the Committee and is a pipeline to future leadership opportunities for Section members.

I wish you all very Happy Holidays!

Holly Nielsen
Committee Chair
Moscow

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## ECT: ONE, TWO, THREE

### A Brief Primer on Investment Protection Under the Energy Charter Treaty

*Brinkley Tappan and Dana Contratto*

### ONE: The History and Purpose of the ECT

The political turmoil of the late 1980s and early 1990s had profound effects on the energy sector in the area encompassing the former Soviet Union. What had been a centrally planned system controlled by the government was opened to the free market, and was simultaneously in need of substantial investment. In Russia, for instance, a lack of investment raised concerns about future production levels, which had the potential to affect not only Russia itself, but also countries throughout Europe, which relied on Russian energy resources.

With the goals of integrating the energy sectors of the former Soviet Union and Eastern Europe into the European (and world) market, and stimulating foreign investment in economies that had been centrally planned, representatives from more than fifty countries convened to negotiate the Energy Charter Treaty in late 1991. Included in that group were Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan, among others. Negotiation of the treaty took close to three years. The Treaty was signed in Lisbon, Portugal on December 17, 1994. By its own terms, the ECT entered into force on April 16, 1998, and applied "provisionally" in all signatory countries, regardless of ratification status. At the time the Treaty entered into force, thirty signatories had ratified it. Today, ratification is still pending in a handful of countries, including Russia and Belarus.

### TWO: Important Provisions of the ECT

The ECT contains two important types of investment protection provisions: those that create investment protections and those that govern the settlement of disputes arising from those investments.

Under the Treaty, protected investments are those made by an individual or company of one signatory country in the energy sector of another signatory country. The investment itself may be comprised of "any kind of asset," including, for example, mortgages, stock, and even intellectual property.

So long as an investment fits within the definitions set forth in the treaty, it will qualify for certain protection from adverse action by the country into which the investment was made ("the host country"). Specifically, Article 13 of the treaty prohibits a host country from nationalizing or expropriating a protected investment, unless it meets certain substantive and procedural requirements, including payment of adequate and effective compensation to the investor. Article 10 of the Treaty provides another measure of protection by prohibiting host countries from treating foreign investments in ways that are incompatible with international law. The protection in Article 10 is broad, but includes, for instance, a requirement that a host country treat a foreign investment at least as favorably as it would treat an investment made by a national of the host country.

The ECT also contains provisions governing disputes that arise out of protected foreign investments. In the event that a foreign investor's investment is impaired by a host country's action, the foreign investor must first attempt to

resolve the dispute amicably. The investor may then pursue a remedy against the host country: (1) in that country's courts; (2) in accordance with a previously agreed settlement procedure; *or* (3) in one of the arbitral fora identified in the ECT. These fora include the World Bank's International Centre for Settlement of Investment Disputes (ICSID), the Stockholm Chamber of Commerce (SCC), or ad hoc arbitration under the auspices of UNCITRAL.

## THREE: A Sampling of Cases Brought Under the ECT

Since 2001, there have been arbitrations brought under the ECT in each of the fora named above – ICSID, the SCC and ad hoc UNCITRAL arbitration. To date, there have been only two final awards rendered in ECT arbitrations, both by the SCC.

The first final award under the ECT was rendered in *Nykomb Synergetics Technology Holding AB v. Republic of Latvia*, on December 16, 2003. In *Nykomb*, the plaintiff, a Swedish joint-stock company, entered into an eight-year contract to build and operate a cogeneration plant through a Latvian joint-stock company, Windau. The Latvian state-run utility, Latvenergo, was to pay Windau a double tariff for these services. When Latvenergo paid 75% of the tariff rather than the 200% required by the contract, Nykomb brought an arbitration action under the ECT. The arbitration panel rejected Nykomb's argument that its investment had been expropriated in violation of Article 13, finding that there could be no expropriation where the state had not taken some degree of possession or control over the investment. Applying Article 10, however, the panel found that Latvia (via Latvenergo) had discriminated against Windau because it had paid other companies a double tariff. On that basis, the panel awarded lost income to Nykomb for the period from the breach to the decision (approximately Euro 3 million); it also ordered Latvia to pay the double tariff for the remainder of the contract's term.

The second final award rendered under the ECT was issued on March 29, 2005. In *Petrobart Limited v. The Kyrgyz Republic*, Petrobart, a company incorporated in Gibraltar, contracted to supply gas condensate to KGM, a state-owned utility in the Kyrgyz Republic, for a period of 12 months. KGM failed to pay for the gas condensate, and Petrobart sued in the Bishkek Court of the Kyrgyz Republic. The court ruled in favor of Petrobart and ordered KGM to pay for the gas. Before Petrobart was able to recover the judgment against KGM, the Kyrgyz Republic transferred all of KGM's assets to two new state-owned companies, foreclosing Petrobart's chances at recovery because of KGM's resulting bankruptcy. The arbitration panel agreed with Petrobart that the actions of the Kyrgyz Republic were general violations of Article 10 of the ECT, in that they constituted less favorable treatment than required by international law. The parties could no longer perform on the contract because KGM had been dismantled; therefore, the tribunal awarded only actual damages, in the amount of $1 million.

The most recent decision to be issued in an ECT case was not a final award, but a preliminary decision on jurisdiction. On July 6, 2007, an ICSID tribunal issued its jurisdictional decision in *Ioannis Kardassopoulos v. Georgia*. The claimant, a Greek national, received a concession to reconstruct energy pipelines and infrastructure in Georgia. Alleging that the concession had been expropriated, Mr. Kardassopoulos filed a claim under the ECT. Georgia objected to jurisdiction on the basis that it had not yet ratified the ECT when the dispute arose. The panel rejected this reasoning and found jurisdiction, relying on the "provisional application" contained in the ECT itself and on the absence of any finding that provisional application would violate the domestic law of Georgia. Clearly, this decision suggests that the ECT will likely still apply to investments made in either Russia or Belarus despite their failure to ratify it formally.

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## UKRAINIAN LEGISLATIVE UPDATE*

*Gene M. Burd and Artem Saprykin*

Pursuant to Presidential Decree No. 675/2007 of July 31, 2007, the Ukrainian Supreme Rada (Parliament) was dissolved and new elections were scheduled for September 30. Accordingly, new legislative activities were limited to the regulations and letters issued by the executive branch.

### NEW BORDER CROSSING RULES

On July 11, 2007, the Cabinet of Ministers issued Resolution No. 917 amending Article 16-1 and also Resolution No. 1014 amending Article 19 of the Rules for Entry, Departure and Transit of Foreigners and Persons without Citizenship Through the Borders of Ukraine.

Revised Article 16-1 of the Rules requires citizens of certain foreign countries to provide documents confirming their financial status. Such documents may include: (i) cash; (ii) drafts written on Ukrainian banks; (iii) credit or debit cards with respective bank statement confirming availability of funds; (iv) receipts for food and lodging paid in advance; (v) travel vouchers; (vi) letter of guarantee issued by the inviting person; and (vii) a return plane ticket.

The list of countries subject to the Rules is to be established by the Cabinet of Ministers. As of the date of this review, the list has not been established. The State Customs Service issued Letter No. 11/2-10/8053-ЕП, dated August 7, 2007, and advised that it will not enforce provisions of the new Article 16-1 until a complete list of countries is established. While we do not anticipate any problems at present, it would be advisable for non-Ukrainian citizens to carry a copy of the August 7, 2007 letter when crossing the Ukrainian border in order to furnish it to border officials, if necessary.**

Revised Article 19 limits the period of registration of foreigners from countries with an established Visa Regime with Ukraine for the period of Visa validity but not for more than 90 days. The previous registration period was 180 days. The new Article 19 is effective as of August 1, 2007.

### LICENSING OF EDUCATIONAL ACTIVITIES

The Cabinet of Ministers issued Resolution No. 1019, dated August 8, 2007, approving new Procedures for Licensing of Educational Activities. The new procedures are effective as of September 1, 2007.

Pursuant to Article 2 of the Procedures, the following activities shall be licensed:

(i) preschool education;
(ii) secondary education;
(iii) out-of-school education;
(iv) professional and technical education;
(v) higher education (institutes, universities, academies).

The principal difference between the new Procedures and the existing ones is that now the licensing is divided into two stages. The first stage is the preparation for licensing in which the educational institution applies to the licensing authority to request the licensing procedure (e.g., to prepare the respective documents charter, internal regulations, substantiations, educational programs and educational plans). After review of the application and documents, the licensing authority (Ministry of Education and Science) will make a decision on the licensing procedure (examination of the applicant). The second stage is the licensing procedure itself (subject to the condition that the licensing authority agrees to start the procedure).

## NEW STRUCTURE OF THE STATE TAX ADMINISTRATION

The Cabinet of Ministers issued Resolution No. 1066, dated August 30, 2007, "On the Amendments to the By-Laws of the State Tax Administration of Ukraine." The new By-Laws define State Tax Administration (STA) as a central executive authority with special status. The STA did not have special status before. The special status of the STA reduces its dependence on the Ministry of Finance of Ukraine.

The STA's new By-Laws streamline its activity and coordinate the activity with the Cabinet of Ministers of Ukraine through the Minster of Finance. The STA is now required to report directly to the President and the Cabinet of Ministers on paid taxes and other mandatory payments. The Deputy-Heads of the STA shall be appointed by the Cabinet of Ministers based on recommendations of the Minister of Finance.

The STA is allowed to create, reorganize and liquidate interregional state tax departments, subdivisions of tax militia and other specialized state tax administrations in coordination with the Ministry of Finance, which provides it with more freedom and flexibility in enforcement of the tax laws. The issue will, of course, be whether this new power will be abused by officials.

## THE MINISTRY OF FINANCE CLARIFIES PROCEDURE FOR THE TRANSFER OF THE DOCUMENTS TO NEW HEAD ACCOUNTANTS

The Ministry of Finance issued Letter No. 31-34000-10-27/13453, dated July 2, 2007, clarifying procedures for the transfer of accounting documents and professional responsibilities when a company replaces a head accountant. The Letter states that companies have a duty to create these procedures. Therefore, it is recommended that companies establish such policies and have them available in the event of the audit.

## FOREIGNERS CAN BE REGISTERED AS PRIVATE ENTREPRENEURS

The State Committee on Regulatory Policy and Entrepreneurship issued a letter No. 5119, dated July 12, 2007, in which it clarified that foreigners are permitted to register as private entrepreneurs. The letter explains that foreigners have this right only if they are in Ukraine in the following visa status:

- B (co-founders of joint enterprises or companies' representatives);
- IM-2 (visa for permanent residence in Ukraine);
- IM-3 (visa for entrance with the purpose of family reunification).

The letter is silent regarding citizens of countries for which a visa is not currently required (e.g., the United States). Although, in general, it could be argued that the Ukrainian Commercial Code, which provides that foreigners have the same rights as citizens to carry out business activities, already provides such a right, it is unclear whether the Committee would agree with this argument.

## IN THE WORKS
## DRAFT LAW ATTEMPTS TO DEAL WITH CORPORATE RAIDERS

In February, Members of the Rada: Portnov (BYuT), Onischuk ("Nasha Ukraina") and Prytyka – former Head of the High Commercial Court (Party of the Regions) introduced in the second reading draft law No. 2819 which prohibits courts from issuing preliminary injunctions enjoining shareholder meetings of corporations. The injunctions ("ukhvala" in Ukrainian) have historically been used to prevent changes in the management of a company. The injunctions are ordinarily issued by corrupt judges under the pretext of false or collusive claims. After the issuance of the injunction, the claim is often abandoned, ultimately resulting, however, in a challenge to the validity of the shareholder meeting. While the law, if adopted, is a step in a positive direction, it is not without a downside. For example, when a shareholder [or management] has legitimate reasons to prohibit shareholder meetings, for instance, when the meeting attempts to oppress minority shareholders, the new law with its wholesale approach will not allow flexibility in such a situation.

Gene M. Burd is a member in the law firm Marks Sokolov and Burd, LLC and the head of its representative office in Kyiv. Artem Saprykin is an attorney in the firm's Kyiv office. Gene Burd can be reached at gburd@mslegal.com and Artem Saprykin at asaprykin@mslegal.com.

**Notes:**

*This Update is provided as of September 2007.

**A copy of the letter in Ukrainian and English is available free of charge from the offices of Marks Sokolov & Burd, LLC. Please contact the authors for more information.

# ABUSE OF RIGHTS UNDER RUSSIAN LAW

*Ekaterina Sjostrand*

Article 10 (1) of the modern Russian Civil Code prohibits, inter alia, any exercise of a civil right with sole intention to cause harm to another person, as well as abuse of rights in other forms. These provisions largely constitute the doctrine of abuse of rights under Russian law. The doctrine is not formally defined and the scope of its application is far from clear. This provides for a considerable difference of opinions among academics and practicing lawyers, as well as (rightly or wrongly) an immeasurable field for judicial discretion. Russian courts have applied (and continue to apply) the doctrine in various situations. It is, therefore, important to analyze its origin, meaning and application by the courts.

## HISTORIC BACKGROUND

Generally, the doctrine of abuse of rights concerns limitations imposed on the exercise of a civil right. Historically, it was meant to deal with extreme vicious ways of exercising the (otherwise absolute) right of ownership and other civil rights.

The origin of the doctrine can be traced back to the ancient Roman law (although the scope and the extent of its application by Roman lawyers are debatable). The first formal legal rule prohibiting abuse of rights and providing for a sanction for breach thereof was set out in Prussian civil legislation at the end of the 18th century. The doctrine (*abus de droit*, was further developed by French lawyers in the 19th century. From the end of the 18th century, a number of European countries started incorporating abuse of rights provisions into their civil legislation.

It should be observed that, whereas the concept of abuse of rights is established and recognized in various civil law jurisdictions, it is not, generally speaking, known in common law countries.

## POSITION UNDER MODERN RUSSIAN LAW

In the modern (post-1917) Russian law, the doctrine could initially be found in the Soviet Civil Code of 1923 which was prefaced by the following principle: "*Civil rights are protected by the law except in those cases in which they are exercised in a sense contrary to their economic and social purpose.*" Article 5 of the 1964 Civil Code of the Russian Federation was to similar effect. The doctrine was retained in Article 10 of the present post-Soviet Civil Code, which reads as follows:

### Article 10. The limits of exercise of civil rights

1. Acts of physical and legal persons carried out with the sole intention of causing harm to another person, as well as abuse of rights in other forms, are not permitted.

The exercise of civil rights for the purpose of limiting competition or abuse of a dominant position in the market is not permitted.

2. Where the provisions of paragraph 1 of the present Article are not complied with, a court or an arbitrazh court or a third party tribunal may refuse to uphold the right in question.
3. Where the law affords protection of civil rights subject to their reasonable and good faith exercise, such reasonableness and good faith of the participants in civil relations is presumed.

As follows from the above, the categories of abuse of rights set out in Art.10 (1) of the Russian Civil Code are: (1) acts of physical and legal persons carried out with the sole intention of causing harm to another person; (2) abuse of rights in other forms; (3) exercise of civil rights for the purpose of limiting competition; (4) abuse of a dominant position in the market.

It is evident from the structure and the wording of Art.10 that the primary examples of abuse of rights are (i) an act by a natural person or legal entity which is performed *"with the sole intention to cause harm to another person*", and (ii) abuse of rights "in other forms". As for (i), it is largely based on the *"Schikaneverbot"* principle contained in paragraph 226 of the early 20th century German Civil Code which stated: *"The exercise of a right is unlawful if its purpose is only to cause harm to another."* The analysis below will focus on the concept of abuse of rights within the meaning of (i) and (ii) above, i.e. *Schikane*[1] and abuse of rights "in other forms".

## ACADEMIC ANALYSIS OF THE DOCTRINE OF ABUSE OF RIGHTS

Various academics made a considerable effort to analyse the concept of abuse of rights under the Soviet law and, subsequently, under Russian law (for example, M.M. Agarkov (1946),[2] V.P. Gribanov (1974),[3] V.I. Emelyanov (2002),[4] T.S. Yatsenko (2003),[5] others). The latest research was published earlier this year (2007) - O.A. Porotikova "*The issue of abuse of a subjective civil law right*". Overall, academic opinion with regards to the usefulness and necessity of retaining the concept in the legal framework has been traditionally (and still is) divided.

Since "abuse of rights" has never been defined in the legislation, Russian legal theory and doctrine has proposed a number of definitions. For example, V.P. Gribanov defines abuse of rights as "*a special type of a civil wrong which is committed by a person in the exercise of a right belonging to him and which is associated with particular impermissible forms [of the exercise of this right] within the limits of a general type of behaviour permitted by the law.*"

There is no uniform position as to the meaning and scope of "abuse of rights". According to T.S. Yatsenko, "*… the absence of a uniform interpretation by the courts of the provisions of Article 10 is an impediment for the functioning of the civil relations;*" this is "*… mainly caused by the absence in the legislation of a precise definition of the concept of abuse of rights including Schikane….*" However, she admits that it is impossible to give an all-encompassing definition of abuse of rights and courts need to decide whether or not a particular behaviour amounts to an abuse of a right based on specific facts of each individual case.

According to V.I. Emelyanov, for an act to be considered a *Schikane*, it should be carried out "*with a direct intent and with the sole purpose to cause harm to another person.*" An example of an act amounting to a *Schikane* would be where the owner of a piece of land changes the course of a stream of water (on his land) in order to divert it from a neighbor's piece of land situated lower, with the sole purpose of causing harm to that neighbor. Therefore, in his view, to amount to a *Schikane*, malice must be the sole motive behind a person's acts, with the exclusion of any other motive. He does not define "malice"; however, it may be deduced that the sole intention to aggrieve or annoy another person without any sensible or legitimate purpose is meant. In his view, since the law specifically refers to "*sole intention*", this legislative provision should not be given such a broad interpretation in respect of *Schikane* as it has been done by German Courts.

O.A. Porotikova expresses a similar view in that "*only the direct sole intent of a person to exercise their right for the purpose of harming another is the distinctive feature of Schikane, as opposed to any other type of abuse [of rights].*"

Russian legal doctrine does not contain a uniform list of elements constituting "abuse of rights" (both as regards *Schikane* and abuse of rights "in other forms"). As may be discerned from the analysis of the concept by various academics, a number of elements have been commonly identified. However, there exist certain differences. The author will attempt to provide a brief summary of those elements which, in her view, best reflect the position: (1) an act that has caused harm to another person(s); (2) committed in the course of the exercise of a specific right; (3) which is the right of the "guilty" party; (4) the abuse must be related to the manner of the exercise of a right, not its contents (definition or scope); (5) the exercise of the right in question must manifestly exceed certain limits, most notably, the purpose for which the right was granted; (6) the abuse may be malicious (i.e. committed with sole intention to cause harm and with the exclusion of any other purpose) or otherwise.

## JUDICIAL PRACTICE

In recent years, Russian arbitrazh courts[6] have shown an increasing tendency to apply the "abuse of rights" provisions of Art.10 of the Civil Code. Examples of this can be found in cases concerning (i) interest rates charged on loans,[7] (ii) contracts for sale of goods/ provision of services containing a so-called "foreign currency clause" (i.e. which provides for the amount of payment to be calculated in a foreign currency, not roubles), (iii) contractual penalties, (iv) landlord and tenant disputes, (v) insolvency-related matters, (vi) certain disputes between shareholders, and so on.

"Abuse of rights" has been pleaded by claimants in a variety of contexts. Often this claim appears to have been inserted in addition to other more straight forward heads of claim – probably, "just to be on the safe side" or "in case nothing else works". Again, this tends to show the vagueness of the doctrine.

The overall practice of application of Art.10 by Russian courts is far from consistent. Since its scope and elements are unclear, it has given rise to conflicting court decisions and considerable differences in the opinions of practicing lawyers and academics. In turn, this provides an enormous field for judicial discretion.

In those cases where courts did accept the argument of abuse of right, it is often difficult to ascertain which exactly form of abuse of right is held to have taken place, i.e. abuse with sole intention to cause harm or abuse of right "in other forms". The courts have a tendency to generally refer to sub-paragraph 1 of paragraph 1 of Article 10 of the Civil Code without clarifying this point in their decisions.

It has also been pointed out that in some instances where courts applied Art.10 (1), the same result may have been achieved by applying other (more specific) legislative provisions. In other instances, Article 10(1) was applied simply to achieve a just result in the absence of any relevant legislative provision or rule dealing with such a situation. This indicates the existence of certain gaps and lacunas in Russian law which need to be filled in by legislature.

## CONCLUSION

The doctrine of abuse of rights under Russian law is full of confusion, which makes it even more difficult to grasp from the perspective of a common law practitioner. Therefore, great caution must be exercised in any attempt to analyze any matter from the point of view of this doctrine or assert abuse of rights in a claim governed by foreign (i.e. Russian) law.

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**Notes:**

[1]Generally, Russian lawyers and academics use the German term "*Schikane*" with the reference to an act carried out with the sole intention to cause harm to another person.

[2]"The doctrine of abuse of rights in the Soviet civil law", "Izvestia of the Academy of Sciences of the USSR", Economics and Law Branch, No 6, 1946.

[3]Limits of Exercise and Protection of Civil Rights" (M., 1974).

[4]"Reasonableness, Good Faith and Non-Abuse of Civil Rights" (M., Lex-Kniga, 2002).

[5]"The concept of *schikane* in civil law: history and the present" (Moscow, Statut, 2003).

[6]The equivalent of commercial courts.

[7]In one such case, a creditor-bank demanded that the debtor pay the interest at the rate of 183% pa for the whole term of the loan. The court ruled that no remedy afforded by civil legislation should lead to enrichment of one party to a contract at the expense of the other. By claiming such a high interest rate in relation to the period when the inter-bank interest rate had been constantly decreasing and had been considerably less than 183% pa, the claimant abused its right to demand payment of interest in respect of the loan (Resolution of the Federal Arbitrazh Court of the Northern Caucus Circuit concerning case No Ф08-575/98). This decision (and other similar ones) attracted criticism from lawyers as defying the fundamental principle of freedom of contract (Art.1 of the Civil Code). Also, it is argued that the same result could have been achieved by applying other provisions of the Civil Code.

Russia/
Eurasia
Committee

**Комитет по России/ Евразии**

## About the Russia/Eurasia Committee

The geographic scope of this committee encompasses Russia, Ukraine, Belarus, Moldova, Georgia, Azerbaijan, Armenia, Kazakhstan, Turkmenistan, Uzbekistan Kyrgyzstan and Tajikistan. The committee considers various current, substantive issues related to this area including among others, business regulations, tax, customs and trade law, intellectual property rights, and nuclear nonproliferation. The Russia/Eurasia Committee Newsletter endeavors to provide relevant information pertaining to current developments in Russia and Eurasian States law and practice, as well as other information of professional interest to its members and other readers.

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## Mark Your Calendars!

ABA International will host its 2008 Spring Meeting in New York, April 1-5. For more information about the Spring Meeting, we encourage you to visit www.abanet.org/intlaw/spring08/Spring2008Agenda.pdf
We hope to see you in New York!