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## Russia's Recent Actions Against Foreign Investors Will Give Rise to Claims Under International Investment Treaties

### INTRODUCTION

Since the Russian Federation's invasion of Ukraine, more than 400 international companies have announced their intentions to scale back or shut down their business operations in Russia. Russia has responded to the exodus of these companies and the recent economic sanctions imposed by Western governments by enacting or threatening counter-measures (the "**Counter-measures**").

**First**, Russia's ruling party has announced draft legislation, expressly endorsed by President Vladimir Putin, that will authorize Russian courts to place Russian companies with foreign shareholders into external administration if they take steps to cease, suspend, or wind down their operations (the "**Nationalization Counter-measure**"). The assets of companies placed in external administration would be transferred to new entities. The shares of these new entities would be auctioned off to preferred Russian bidders or to the Russian government itself.

**Second**, Russia has imposed restrictions on the ability of foreign investors to divest their shares in Russian subsidiaries and immovable property, as well as on the transfer of proceeds or other funds denominated in foreign currency without an express license from the Russian government (the "**Transfer Counter-measure**").

This Client Alert considers the implications of Russia's Counter-measures and the protections available to foreign investors under bilateral or multilateral investment treaties.

### RUSSIA'S NATIONALIZATION COUNTER-MEASURE: PROPOSED LEGISLATION

United Russia, Russia's majority political party, has proposed new draft legislation that would apply to Russian companies if 25% or more of their shares are owned by foreign shareholders based in "unfriendly" states, including the European Union, United Kingdom, and United States.<sup>1</sup> If the "unfriendly" foreign owners or a Russian company's management cease or suspend operations in Russia, members of the Russian company's board or certain government officials would be able to



apply to a local commercial court for “external administration” of the Russian company. “External administration” is a reorganization under Russia’s bankruptcy law, with an external manager immediately displacing current management.

If, within five days, the foreign owners or the company’s management were to reverse their decision to leave Russia or cease operations in Russia (or agree to continue operations pending a sale to a buyer that will continue running the business), the external administration proceedings would be withdrawn.<sup>2</sup> However, if they do not reverse their decision, the company’s assets would be transferred to a new company, and the new company’s shares would be sold at auction.

Russia’s proposed nationalization legislation already invites careful attention from companies with operations in Russia, even though provisions of the draft legislation are still being debated. On March 16, 2022, Russia’s Central Bank reportedly argued that the criteria to determine which companies may be put into administration should be clearer and that alternative mechanisms to administration should be considered.<sup>3</sup> In addition, Russian media have reported that the draft legislation, if it becomes law, may ultimately provide not only for the nationalization of companies’ assets but also for a “ban” on certain foreign companies returning to Russia for up to ten years.<sup>4</sup> However, despite President Putin expressly endorsing United Russia’s proposal on March 10, 2022, in the two weeks since March 16, the media have reported very little, and it remains unclear if the proposed legislation has made significant progress.

### RUSSIA’S TRANSFER COUNTER-MEASURE: RESTRICTIONS ON TRANSFERS OF SHARES AND FUNDS

The significant impact of Ukraine-related sanctions has prompted Russia to limit the ability of foreign investors and their Russian subsidiaries to transfer shares, immovable property, or foreign currency-denominated funds. On March 1, 2022, the Russian Duma issued a Decree on Additional and Temporary Economic Measures to Ensure Financial Stability of the Russian Federation (the “**March 1 Decree**”). This Decree requires parties from “unfriendly” states and the Russian companies they control to obtain a license from the Government of Russia or the Central Bank of Russia before transferring: (i) shares and other securities in those Russian companies; (ii) immovable property; and/or (iii) foreign currency to persons or institutions located outside Russia.

The March 1 Decree materially limits the ability of foreign investors to exit their Russian investments by restricting them from transferring their shares in Russian companies without an express license from the Russian government or the Central Bank. Although it is not specifically directed against foreign companies that seek to wind down their operations in Russia, the March 1 Decree effectively prevents those companies from selling their investments to other Russian or foreign companies or individuals and from repatriating the resulting proceeds. In light of the proposed Nationalization Counter-measure, which by its terms is intended to maintain the value of foreign investment-backed companies within the territory of Russia, it is unlikely that the Russian government or the Central Bank would grant a license to a foreign investor authorizing it to transfer the value of its investment outside of Russia.

### RUSSIA’S INTERNATIONAL INVESTMENT AGREEMENTS PROTECT FOREIGN INVESTORS

As Russia’s new and potential future Counter-measures likely will adversely affect many investors from a wide range of states, Russia and the international community may reach a diplomatic solution and establish an international claims commission to adjudicate any claims against Russia emanating from the Counter-measures. In 1981, Iran and the United States agreed to establish the Iran-United States Claims Tribunal (the “**IUSCT**”) in The Hague as part of the resolution of the November 1979 hostage crisis at the U.S. Embassy in Tehran. In exchange for Iran agreeing to release the hostages, the United States agreed to release Iranian assets frozen in the United States, terminate any pending litigations against Iran in U.S. courts, and resolve any claims between U.S. nationals against Iran through binding arbitration at the IUSCT. A similar claims commission, the United Nations Compensation Commission, was established to process claims and pay compensation for losses following Iraq’s invasion of Kuwait in 1990-1991.

If, however, the international community is unable to reach a diplomatic solution and establish an international claims commission, foreign investors who suffer losses as a result of Russia’s Counter-measures may be able to seek redress under the network of international investment agreements that Russia has concluded with other states, depending on how their investments are structured. There are currently 62 bilateral investment treaties (“**BITs**”) in force between Russia and key jurisdictions such as Canada, the Netherlands, Singapore, Switzerland, Turkey, the United Arab Emirates, and the United Kingdom, but not the United States. Russia is also party to several multilateral treaties that provide investment protection guarantees, most notably the Energy Charter Treaty (the “**ECT**”). Although Russia never ratified the ECT and sought to terminate its provisional application in 2009, the ECT contains a 20 year “survival”



mechanism. This arguably means that Russia will remain bound by investment protection guarantees in the ECT until 2029. These investment treaties provide investors and their investments in Russia with several protections, although the scope and nature of those protections will vary depending on the particular treaty, and allow affected investors to bring legal claims directly against Russia for violations of these guaranteed protections.

### **GUARANTEE TO PROMOTE AND PROTECT INVESTMENTS AND PROHIBITION ON IMPAIRMENT OF INVESTMENTS**

Many Russian BITs contain broad guarantees by Russia to “encourage and create favorable conditions for investors of the other [treaty state] to make investments in its territory.”<sup>5</sup> These provisions affirmatively obligate Russia to “create favorable conditions” for foreign investment in Russia.

The corollary to such affirmative obligations is the prohibition contained in many of its BITs against “impair[ing] by unreasonable or discriminatory measures, the operation, management, maintenance, use, enjoyment or disposal thereof” by investors of the other state.<sup>6</sup> Thus, Russia’s positive obligation to create a favorable investment environment and its negative obligation not to impair investments through unreasonable or discriminatory measures operate in tandem to guarantee covered investors the right to an investment environment in which they can operate, manage, use, and dispose of their investments. These rights necessarily include the ability to transfer shareholding interests in Russian companies as well as funds denominated in foreign currency.

### **FAIR AND EQUITABLE TREATMENT**

Many Russian BITs also contain provisions requiring each state party to the treaty to “accord in its territory fair and equitable treatment to investors of the other [treaty state].”<sup>7</sup> Russia’s Counter-measures likely violate this standard and actively discriminate between investors from “unfriendly” states and investors of other states. In addition, depending on the specific language of the BIT, different treatment between foreign and domestic investors may also give rise to liability.

### **EXPROPRIATION**

Russia’s BITs generally contain provisions prohibiting expropriation or nationalization of investments except for a public purpose, in accordance with due process, on a non-discriminatory basis, and upon prompt payment of adequate and effective compensation.

The proposed Nationalization Counter-measure contemplates placing foreign investments in external administration proceedings for subsequent transfer to the Russian state or third-parties without compensation. Depending upon the particular circumstances surrounding an investment, foreign investors may have grounds for arguing that Russia’s actions do not satisfy the criteria for a lawful expropriation, at a minimum because the expropriation treats investors from “unfriendly” states differently from other investors and the expropriation would also be uncompensated.

### **FREE TRANSFER OF FUNDS**

Many Russian BITs also contain express guarantees regarding the rights of covered investors to freely transfer “payments related to the investment,” including “the proceeds of sale or liquidation of the investment which are due to the investor.”<sup>8</sup>

Russia’s Transfer Counter-measure restricts transfers of shares in the Russian subsidiaries of foreign investors, as well as transfers of funds absent an express license from the Russian government or the Central Bank of Russia. These restrictions on transfers of shares and funds could well give rise to violations of the express guarantees on free transfers of funds made by Russia in its BITs.

### **“OPEN-AND-SHUT CASE”?**

Foreign investors’ claims against Russia’s nationalization of their investments may face significant—but not insurmountable—hurdles. Under the proposed Nationalization Counter-measure, Russian courts would be authorized to place a foreign investment-backed Russian company into external administration in two scenarios. The first scenario would be when the Russian company’s management or its “unfriendly” foreign shareholders have *de facto* ceased operating the company by, for example, leaving the territory of Russia without appointing replacement managers or by



taking actions that result in a significant devaluation of the company's assets or its inability to perform its contractual obligations. The second scenario would be when the Russian company's management or its "unfriendly" foreign shareholders take actions resulting in the suspension or cessation of business activities, the termination of key contracts, or the unemployment of more than one-third of its workforce. Russia may seek to avoid liability for the nationalization of the foreign investor's investment by arguing that the investor's actions demonstrate its intent to abandon its investment in Russia. Investors may argue that these actions were required to comply with sanctions imposed by their home state and in response to rapidly deteriorating market conditions in Russia, and that applicable BITs recognize their entitlement to take such steps in the use and disposition of their investments.

Separately, Russia may attempt to invoke the defense of necessity, arguing that the risk of economic and social disruption resulting from the sudden cessation of many businesses left it with no choice but to take over the foreign-owned companies to avoid economic and social catastrophe. To invoke the defense, Russia must demonstrate that its nationalization of the assets is "the only way for [Russia] to safeguard an essential interest against a grave and imminent peril."<sup>9</sup> This is a high standard. Argentina achieved only limited success in invoking necessity to defend the measures that it took during its economic crisis in the early 2000s, underscoring the difficulty that Russia will face in establishing that an economic crisis triggered by its own acts against a foreign state justifies its breaches of treaty obligations owed to foreign investors.

Indeed, international law authorities are clear that Russia cannot invoke necessity if it "contributed to the situation of necessity."<sup>10</sup> It is highly likely that an investment arbitration tribunal would conclude that Russia contributed to the situation of necessity by taking actions against Ukraine that resulted in the imposition of sanctions and adverse public opinion. This is particularly true in light of the International Court of Justice's March 16, 2022 provisional order that found no evidence supporting Russia's justification for its invasion of Ukraine. Given the provisional nature of this order, it is expected that the ICJ will make further permanent orders in due course.

### "SHOW ME THE MONEY!"

A critical question for any foreign investor that would be subject to Russia's Counter-measures is the quantum of damages that it would be able to recover if it brings a claim against Russia under a BIT. Many Russian BITs measure the standard of compensation for expropriation as the fair market value of the investment immediately before the expropriation occurred or became public knowledge, although some have found a later valuation date to be appropriate if the host state's actions are unlawful. Arbitral tribunals generally apply a similar measure of compensation for other treaty breaches (e.g., a breach of the fair and equitable treatment standard). Accordingly, the amount of any compensation awarded may vary significantly as a function of how the investor frames its claim and which treaty breaches it proves.

In the likely event that Russia fails to voluntarily pay an adverse arbitral award, a foreign investor will need to enforce its award against Russian state-owned assets located outside Russia. The Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958 (the "**New York Convention**") is a multilateral treaty that requires its 169 Contracting States (which include Russia) to recognize and enforce arbitration awards rendered in other Contracting States, subject to very limited exceptions. Although enforcement will pose significant challenges, international sanctions regimes have frozen many billions of dollars in Russian assets. To the extent that investors can identify frozen assets belonging to Russian state-owned entities that are recognized to be the alter ego of the Russian state, the investors may seek a license from the applicable sanctions authorities to enforce arbitral awards against such assets.

### CONCLUSION

Russia's new and potential future Counter-measures will likely have a significant impact on foreign investors doing business in Russia. We recommend that foreign investors:

- continue to closely monitor the rapidly evolving developments in Russia;
- understand whether, and if so, to what extent, their investments in Russia are protected by international investment agreements;



- carefully plan their actions and public statements before announcing any decision regarding their investments in Russia, especially to cease, suspend, or wind down their operations in Russia, in order to protect their rights under international law; and
- consider, if the recent restrictions have adversely affected their business in Russia, whether to seek redress under international investment treaties because planning ahead and acting quickly may enable investors to move to the front of the line against competing creditors.



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<sup>1</sup> A list of “unfriendly” states was introduced by the Russian government in response to recent foreign sanctions. In addition to Canada, the EU, the UK, and the US, the list also currently includes Albania, Andorra, Australia, Iceland, Japan, Lichtenstein, Micronesia, Monaco, Montenegro, New Zealand, North Macedonia, Norway, San Marino, Singapore, South Korea, Switzerland, Taiwan and Ukraine. As other states impose sanctions, we expect the list to grow.

<sup>2</sup> It is unclear whether and how foreign owners could agree to continue operations, given the impact of sanctions as well as restrictions on transfer of funds on their business activities.

<sup>3</sup> See <https://www.interfax.ru/business/829556> (available in Russian only).

<sup>4</sup> See <https://russian.rt.com/business/news/977262-zapret-kompanii-sankcii-gosduma> (available in Russian only).

<sup>5</sup> See, e.g., Singapore-Russia BIT, Article 3; UK-Russia BIT, Article 2(1); see also Netherlands-Russia BIT, Article 2 (“Each Contracting Party shall within the framework of its laws and regulations promote economic cooperation through the protection in its territory of investments or investors of the other Contracting Party.”).

<sup>6</sup> See, e.g., Netherlands-Russia BIT, Article 3(1); UK-Russia BIT, Article 2(2).

<sup>7</sup> See, e.g., Singapore-Russia BIT, Article 4(1); see also Netherlands-Russia BIT, Article 3(1) (“Each Contracting Party shall ensure fair and equitable treatment to the investments of investors of the other Contracting Party”); UK-Russia BIT, Article 2(2) (“Investments of investors of each Contracting Party shall at all times be accorded fair and equitable treatment”); UAE-Russia BIT, Article 3(1) (“Each Contracting Party shall ensure in its territory fair and equitable treatment of the investments made by investors of the other Contracting Party related to management, maintenance, use, enjoyment or disposal of the investments”).

<sup>8</sup> Netherlands-Russia BIT, Article 4; see also Singapore-Russia BIT, Article 7; UK-Russia BIT, Article 6; UAE-Russia BIT, Article 6.

<sup>9</sup> See International Law Commission, Draft Articles on Responsibility of States for Internationally Wrongful Acts, Art. 25.

<sup>10</sup> See International Law Commission, Draft Articles on Responsibility of States for Internationally Wrongful Acts, Art. 25.