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## From the Lena Goldfields Case to the Yukos Shareholders Cases: State Control over Strategic Subsoil Vs Protection of Foreign Investors' Interests

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**UNIVERSITÉ  
DE GENÈVE**

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Master Thesis in International Investment Law

**From the Lena Goldfields Case to the Yukos Shareholders Cases**  
-  
**State Control over Strategic Subsoil Vs Protection of Foreign Investors' Interests**

**Mathurin Baquié**

4 April 2017

## **Summary**

International investment law and arbitration have become attractive to solve expropriation cases between a state and foreign investors. Such evolution is mainly based on key cases. The 1930 *Lena Goldfields, Ltd vs USSR* case directly contributed to the recognition of arbitration and the definition of several international legal principles that have gradually been acknowledged as the minimum standards of international investment law. Moreover, the *Lena Goldfields* case has clearly showed that legal considerations and enforcement of the arbitration award are influenced by geopolitical matters, especially when strategic subsoil is involved. If societies with different (ideological) references are in latent conflict, arbitration in international investment law turns out to be a weapon. Such approach continues to be valid when capitalism prevails and private entities gain economical strength in a weakened state. The 2000's *Yukos Shareholders vs Russian Federation* cases further illustrate it, as the geopolitical force of a country is notably defined by its standing on the energy market. To fully grasp the way in which the above-mentioned cases have contributed to the international jurisprudence, the two parts of the current manuscript will follow the same structure. First, will be presented the global historical context and the local history. Then, will be described the chronological phases of the cases and briefly analyzed the key legal aspects of the cases.

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## Table of Abbreviations

ARCOS	All-Russian Co-operative Society
<i>Arbitrazh</i>	Arbitration
Art.	Article
BIT	Bilateral investment treaty
BV	<i>Besloten vennootschap met beperkte aansprakelijkheid</i> ; Dutch version of a private limited liability company
BP	British Petroleum PLC
CFO	Chief financial officer
CIS	Commonwealth of Independent States
CPSU	Communist Party of the Soviet Union
<i>Demokratizatsiya</i>	Democratization
Dept.	Department
DK-Russia BIT	Agreement between the Government of Denmark and the Government of the Russian Federation concerning the Promotion and Reciprocal Protection of Investments on 4 November 1993
ECA	Export credit agency
ECT	Energy charter treaty
ECHR	European Convention on Human Rights, formally the Convention for the Protection of Human Rights and Fundamental Freedoms
ECtHR	European Court of Human Rights
ECG	Export credit guarantee
ECGD	Export Credits Guarantee Department
ed.	Edition
EPA	Economic partnership agreement
<i>et al.</i>	<i>et alii</i>
EU	European Union
<i>Ekonomicheskaya Zhizn</i>	Economic Life; founded on 6 November 1918, the oldest high-volume and most reputable economic/corporate weekly newspaper in Russia
FDI	Foreign direct investment
FET	Fair and equitable treatment
ff	Following
fn.	Footnote
FSB	<i>Federal'naya sluzhba bezopasnosti Rossiyskoy Federatsii</i> ; Federal Security Service of the Russian Federation; the principal security agency of Russia and the main successor of KGB since 12 April 1995
FTA	Free trade agreement
GAAP	Generally Accepted Accounting Principles
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
<i>Glasnost</i>	Openness
<i>Gosbank</i>	<i>Gosudarstvennyi Bank SSSR</i> ; Soviet State bank
<i>Gossnabsbyt'</i>	State Committee for Material-Technical Supply
ICSID	International Centre for Settlement of Investment Disputes
ICSID Convention	Convention on the Settlement of Investment Disputes between States and Nationals of other States; also called Washington Convention
<i>Ibid.</i>	<i>Ibidem</i>
IAs	International investment agreements
IIL	International investment law

ILC	International Law Commission
IMF	International Monetary Fund
INF	Intermediate-range nuclear forces
<i>infra</i>	Below
IPPA	Investment Promotion and Protection Agreement
ISDS	Investor-State Dispute Settlement
<i>Izvestia</i>	news or reports, newspaper of record in the Soviet Union from 1917 until the dissolution of the USSR in 1991
JSC	Joint-stock company
<i>Khozraschyot</i>	Economic accounting
KGB	<i>Komitet gosudarstvennoy bezopasnosti</i> ; Committee for State Security; the main security agency for USSR from 1954 until its collapse in 1991
lit.	<i>Littera</i>
LLP	Limited liability partnerships
<i>Loc. cit.</i>	<i>Loco citato</i>
Ltd	Limited
MAI	Multilateral Agreement on Investment
NAFTA	North American Free Trade Agreement
NEP	<i>Novaya Ekonomicheskaya Politika</i> ; New Economic Policy from 21 March 1921 to 1928
No.	Number
OAO	<i>(Publichnoe) Akcionernoe Obshtestvo Apatityhleb</i> ; refer to OJSC
OOO	<i>Obshchestvo s ogranichennoy otvetstvennostyu</i> ; Limited liability company in Russia and in some other successor states of USSR
Oblast	province, administrative division of Russia, other former countries of USSR and former Kingdom of Serbs, Croats and Slovenes (i.e. Yugoslavia); Oblasts were subdivided into districts and cities/towns
OECD	Organisation for Economic Co-operation and Development
OJSC	Open joint-stock company or Public joint-stock company; a type of company in Russia and in some other successor states of USSR, which is similar to a limited liability partnership except notably that stockholders have the right to trade in stocks without the permission of the others
OGPU	<i>Obyedinyonnoye gosudarstvennoye politicheskoye upravleniye</i> ; Joint State Political Directorate under the Council of People's Commissars of the USSR; Secret police of the Soviet Union from 1923 to 1934
<i>Op. cit.</i>	<i>Opere citato</i>
O.S.	Old Style date, related to the Julian Calendar. In Russia, 31 January 1918 (first day of the Julian calendar) was followed by Thursday, 14 February 1918 (first day of the Gregorian calendar)
p.	Page
<i>Perekhod</i>	Transition (from communism to democratic free enterprise)
<i>Perestroika</i>	Restructuring
PhD	Philosophical Doctorate
pp.	Pages beginning from xxx
PCIJ	Permanent Court of International Justice
PLC	Public limited company
PSA	Production Sharing Agreement
PwC	PricewaterhouseCoopers LLP
RMS	Royal Mail Ship



RSFSR	<i>Rossiyskaya Sotsialisticheskaya Federativnaya Sovetskaya Respublika</i> Russian Socialist Federative Soviet Republic; from 10 July 1918 to 05 December 1936
<u>RSFSR</u>	<i>Rossiyskaya Sovetskaya Federativnaya Sotsialisticheskaya Respublika</i> Russian Soviet Federative Socialist Republic; from 05 December 1936 to 25 December 1991
SA	<i>Sociedad Anónima</i> , anonymous company; roughly equivalent to public limited company in common law jurisdictions
<i>Sarl</i>	<i>Société à responsabilité limitée</i> ; Society of limited responsibility; broadly equivalent in UK to a private company limited by shares, and in USA to a limited liability company
<i>Sevodnia</i>	Russian twice daily newspaper quite influential in the Baltic region, initially published by the Jewish Riti corporation and later by the government
SICAV	<i>Sociedad de inversión de capital variable</i> ; "Investment company with variable capital"; similar in USA to an open-ended mutual fund
SRR	<i>Sovetskaya Rossiyskaya Respublika</i> ; Soviet Russian Republic; that existed from 25 January 1918 to 10 July 1918
TNK	OJSC <i>Tyumenskaya Neftyanaya Kompaniya</i> ; Tyumen Oil Company
TTIP	Transatlantic Trade and Investment Partnership
UK	United Kingdom
UK-Soviet BIT/IPPA	Agreement between the Government of the United Kingdom and the Government of the USSR for the Promotion and Reciprocal Protection of Investments signed on 6 April 1989
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
USA	United States of America
USSR	<i>Soyuz Sovetskikh Sotsialisticheskikh Respublik</i> ; Union of Soviet Socialist Republics; that existed from 30 December 1922 to 25 December 1991
VAT	Value Added Tax
Vol.	Volume
WWI	World War I
WWII	World War II
SCC	Stockholm Chamber of Commerce
SNK	<i>Soviet narodnykh kommissarov</i> or <i>Sovnarkom</i> ; Council of People's Commissars; from 1917 to 1946 (subsequently called Council of Ministers of the Union of Soviet Socialist Republics or Soviet of Ministers)
SSR	Soviet Socialist Republic
<i>Uskoreniye</i>	Acceleration
<i>Za Industrializatsiiu</i>	For Industrialization; leading Soviet economics newspaper which was previously named <i>Torgovo-promyshchlennaia gazeta</i> ("Commerce and Industry Newspaper") until 1930
<i>Zastoi</i>	Stagnation

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## I. Introduction

Any human activity requires energy. Furthermore, expansion of mankind has diversified, notably through trade, the need of resources. The industrialization era and later on globalization have drastically increased the demand especially for natural resources, such as fossil fuels or metals. Knowing that natural resources are in limited amount and, moreover, unevenly distributed on Earth the race for energy and resources has intensified. In this context, rich subsoil appears as a strategic asset for the (fortunate) owning country. This country, e.g. Russia, may gain significant power on the geopolitical scene.

However, subsoil extraction requires major financial investments and adapted technology knowledge. As wealth and know-how are mainly concentrated in specific spots, e.g. the Western financial and technological centers such as London or New York for the present periods of interest, probability is high that the subsoil-rich country is bound to rely on this Western support in order to improve its own development. To attract alien (Western) investors, i.e. public or private institutions, contracts must include conditions to secure future benefits as well as sufficient freedom to operate. In parallel, the agreements must take into account interests of the subsoil-owning country and its people. Thus, taken together, agreements should be balanced to optimize cooperation and completion of the respective objectives of the parties.

As the situation may evolve defavourably in some cases, one of the parties may breach the contract, which thus triggers legal issues. One of the most prominent problems consists in the applicable law. The foreign investor might fear to be underprotected if the case is judged in the host country and under the local national laws. Indeed, the host country may adapt the law to fit its own interests and influence the judgement. On the other hand, the host country might not consider acceptable that issues related to its strategic subsoil would be judged according to non-national standards.

At that point, international investment law and arbitration, as alternative dispute resolutions, become attractive to solve the cases. Common patterns and consensus have been gradually defined throughout the years to guide the arbitrators in the proceedings. Some former cases have more contributed than others to the development of jurisprudence. Such reference cases tend to push forward the boundaries of international investment law as they involve several complex legal issues that are intricately linked to geopolitical concerns. To illustrate the relevance and importance of international investment law throughout modern time, will be discussed the following arbitration cases: 1930 Lena Goldfields, Ltd vs USSR Case (part II) and subsequently the 2000's Yukos Shareholders vs Russian Federation Cases (part III). All these cases took place in troubled times in Russia where societal and legal references were violently questioned and rewritten with blood, sweat and tears.

Noteworthy, the British Lena Goldfields Ltd concession with thirteen separate industrial complexes was the largest concession agreed by the Soviet Union. It was valued over USD 89 million in 1930.<sup>1</sup> While Stalin decided to transition from the NEP to the First Five-Year Plan and hastily launch the mass collectivisation, the concessions such as Lena Goldfields were pressured in multiple manners to disappear. To compensate the indirect expropriation, Lena Goldfields Ltd called for arbitration. It was the only international law case in which the Soviet Government was a party, even though they decided in the end to acknowledge neither the international arbitration principle nor the award. According to the Soviet agenda and in order to preserve communist revolutionary principles, capitalist concessions were considered to have already provided sufficient technology transfer and investment to stimulate Soviet production growth. It was time to eject capitalist concessions from USSR. During that period, the UK was torn apart by contradictory interests, as reflected by the switching political decisions of its successive governments in favor or against Soviet Union. On one hand, like any Western country, the UK was engaged in fierce competition to rebuild its economy by any means (including the promotion of the penetration of the Soviet market) after the turmoil of WWI, while on the other hand it feared and fought communist expansion. Thus UK-USSR relationship

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<sup>1</sup> A.C. Sutton, *Western Technology and Soviet Economic Development 1917 to 1930*, 1968, p. 8

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remained globally chaotic.<sup>2</sup> The Lena Goldfields case clearly shows that legal considerations and award payments are fully immersed and influenced by geopolitical matters. As the legal system reflects the principles of the society it regulates, what happens when societies with different (ideological) references, like the Western and Russian systems, litigate?

The Lena Goldfields case directly contributed to the definition of several international legal principles that have gradually been acknowledged as the minimum standards of international investment law.<sup>3</sup> It notably confirmed the prevalence of international law over national law, which was a debated topic at that time.<sup>4</sup> Some developing countries privileged the 1868 doctrine of Argentine jurist Carlos Calvo that considered legal nationalism: the jurisdiction in international investment disputes had to be the host country courts, rather than those of the investor's country. In concession contracts, the Calvo doctrine clause implied that diplomatic protection or (armed) intervention was to be prohibited before local resources were exhausted.<sup>5</sup> Such approach was further supported by the 1902 doctrine of the Argentine Minister of Foreign Affairs Luis María Drago.<sup>6</sup> It forbade foreign powers, including USA, to use force against a Latin American nation to collect debt.<sup>7</sup> The purpose of such drastic policy was to notably counter the Gunboat diplomacy<sup>8</sup> or Big Stick diplomacy<sup>9</sup> of Britain, Germany and Italy, which in 1902 had blockaded the Venezuela ports in order to oblige the latter to reimburse its massive debt.<sup>10</sup> Now, thanks to notably the Lena Goldfields case, arbitration is fully recognized in international investment disputes and the international legal principles are globally applied. However, the enforcement of the arbitration award remains a key issue as depicted in the following cases.

Regarding the Yukos Shareholders cases, they illustrate the fact that arbitration in international investment law has become a weapon, as the geopolitical force of a country is notably defined by its standing on the energy market. Noteworthy, some large companies have now gained so much power that they can challenge states. However, they remain obliged to maintain good standing on the market to keep influence. As market is volatile, struggle around it is thus crucial for the survival of each (either public or private) entity.<sup>11</sup> In the Yukos Shareholders cases, the arbitration tribunals showed freedom in their use of the international legal principles, as initiated in the Lena Goldfields case. However, the limitations of the system are still important, notably (i) the difficulty to fully identify a party that is a multi-layers private entity or (ii) to oblige a powerful state to recognize a decision from an independent non-national tribunal. Thus, a careful long-term planning of the arbitration steps is mandatory to make the system of relevant use for the patient but pro-active claimant.

By considering two different periods (i.e. 1920's-30's and 2000's), some perspectives can be defined in international investment law and arbitration. To fully grasp the way in which the above-mentioned cases have contributed to the international jurisprudence, the two parts of the current manuscript will follow the same structure. First, will be presented the global

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<sup>2</sup> Annex 1 - Anglo-Russian Relations from 1856 to 1950

<sup>3</sup> R. Dolzer and C. Schreuer, *Principles of International Investment Law*, 2012, pp. 2; A.H. Roth, *The Minimum Standard of International Law Applied to Aliens*, 1949, pp. 1; E. Brochard, *The diplomatic protection of citizens abroad* or *The law of international claims*, 1915, pp. 1

<sup>4</sup> E. Root, "The basis of Protection to Citizens Abroad", 1910, pp. 517

<sup>5</sup> C. Calvo, *Derecho internacional teorico y practice de Europa y America 1868*, vol. 1, 2012, pp. 1;

<sup>6</sup> H.A. Moulin, *La doctrine de Drago: questions de droit des gens et de politique internationale*, 1908, pp. 1

<sup>7</sup> L. Schoultz, *Beneath the United States: A history of U.S. policy toward Latin America*, 1998, pp. 179

<sup>8</sup> J. Cable, *Gunboat Diplomacy 1919-1991: Political Applications of Limited Naval Force*, 1994, pp. 10; C. Calvo, *Le droit international théorique et pratique*, 1887, pp. 138

<sup>9</sup> "Speak softly and carry a big stick; you will go far." quoted from T. Roosevelt, Letter from Governor of New York Theodore Roosevelt to Henry L. Sprague, 26 January 1900; T. Roosevelt, *Theodore Roosevelt: An Autobiography*, 1913, p. 522

<sup>10</sup> B.S. McBeth, *Gunboats, corruption, and claims: foreign intervention in Venezuela 1899-1908*, 2001, pp. 55

<sup>11</sup> R. Sakwa, *Putin and the oligarch: the Khodorkovsky-Yukos affair*, 2014, pp. 72

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historical context (A) and the local history (B). Then, will be described the chronological phases of the cases (C) and briefly analyzed the key legal aspects of the cases (D).

## **II. The Lena Goldfields Case**

### **A. Global Historical Context**

To enlighten a legal case, understanding the context is of great importance. Moreover, when considering a case in international investment law, the historical context is instrumental. Regarding the Lena Goldfields Case, we need to unravel the period from 1846 to 1932 that corresponds to the British free trade policy. As the parties consisted of the Lena Goldfields Ltd, a private English entity, and the Soviet Union, it appears relevant to study the evolution of relationships between UK and the Russian empire that later became SRR, RSFSR and finally USSR. While Russian policy experienced major subsequent changes during that period, UK was internally challenged by competing forces (notably anti-communist convictions and international commercial competition) to define an official reaction. Such moving situation led to the adoption of fluctuating British positions and erratic protective measures for its national companies, such as the Lena Goldfields Ltd.

This section of the manuscript will be divided in six chronological parts to visualize the different political periods of Russia: Russian Empire era; Disaster of First World War and twilight of the Romanov; End of World War I and 1917 Russian Revolution; Russian Civil War (November 1917-October 1922); New Economic Policy (21 March 1921-1928); and finally Great Turn and First Five Year Plan (1928-1932).

#### **1. Russian Empire Era**

The Industrial Revolution initiated in UK strengthened the British Empire and led to a period often referred to as Pax Britannica. With the pound sterling being the preferred reserve currency of the world and the Bank of England the hub of international finance, UK started to globally promote free trade in 1846. At the geopolitical level, the British Empire reinforced its hegemony by maintaining a balance of power in Continental Europe and by playing the so-called Great Game in the Middle East and Afghanistan to protect the routes to India from Russian ambitions, i.e. the race to the South and the “warm seas”.<sup>12</sup>

The other European powers quickly reacted to free trade by signing agreements, which were perceived as an alternative to war. France and UK initiated the trend on 23 January 1860 with the Cobden-Chevalier Treaty.<sup>13</sup> However, protectionism quickly reappeared. Countries promoted replication of industrial techniques and in parallel created protective customs tariffs on foreign manufactured goods and foodstuffs at their respective borders, e.g. the Méline tariff in France in 1892.<sup>14</sup> Moreover, they subsidised local entities for their respective national developments, e.g. expansion of the railroad network.<sup>15</sup>

Such competition globally led to a steep increase in world trade but at the same time pressure on production conditions rose. UK, which was at the forefront of industrialization, saw urbanization and unionization of its population. Social unrest in the working class and demand for participation in democratic politics stimulated the adoption of the Representation of the

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<sup>12</sup> W.A. McDougall, “Introduction” in *20th-century international relations – politics*; E. Ingram, “The Great Britain's Great Game: An Introduction”, pp. 160; E. Ingram, *In Defence of British India: Great Britain in the Middle East 1775-1842*, pp. 7; M. Ewans, *Afghanistan: A Short History of Its People and Politics*, p. 1

<sup>13</sup> International Monetary Fund Research Dept., *World Economic Outlook May 1997, Globalization: Opportunities and Challenges*, p. 113; J. Morley, *The Life of Richard Cobden*, p. 711; L. Woodward (Sir), *The Age of Reform, 1815-1870*, p. 179

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<sup>15</sup> W.A. McDougall, “Introduction” in *20th-century international relations – politics*; W. Kirchner, *History of Russia*, pp. 217;

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People Act in 1867 (even though the male suffrage was still dependent upon property qualifications).<sup>16</sup>

In other countries, like the German Empire, the rapidity of industrialization affected the direct survival of pre-capitalist elites to such an extent that some social reforms were agreed to limit the discontent of workers. However, political options remained highly controlled as opposition forces had aggressive programs, e.g. the Social Democratic Party of Germany (SPD) was promoting Marxism. Consequently, the working class had no perspective to hope peaceful changes in state policy.<sup>17</sup>

In the case of Russia, backwardness negatively impacted the development potential of the country. A vivid example is the emancipation of the serfs that only occurred in 1861.<sup>18</sup> The problem faced by the successive Romanov Tsars<sup>19</sup> was that the necessary reforms (in all the sectors, e.g. education, agriculture, technology) and industrialization of the country would create a novel urban working class in an empire mainly agrarian. The proletariat concentrated in towns would call for social changes as it did in the more economically advanced countries and would shake the rigid but fragile structure of the empire to the very top.<sup>20</sup> Indeed, the Romanov absolute monarchy had already been negatively impacted by a series of disastrous defeats in the Crimean War (October 1853 - March 1856; against an alliance of UK, France, the Ottoman Empire and the Kingdom of Sardinia) and the Russo-Japanese war (8 February 1904 - 5 September 1905) that stopped the Russian ambitions in the South and the Far East.<sup>21</sup>

Despite these major setbacks, Russian economy grew. The government launched stimulating projects such as the gigantic 5'500 km-long Trans-Siberian railroad (which was decided on 9 March 1891 and completed in 1903).<sup>22</sup> In addition, the population had doubled between 1850 and 1910 and reached 150 million,<sup>23</sup> which created a large potential market for foreign exporters (mainly British and German).<sup>24</sup> Interestingly, while the German Empire trusted the first place (47.4% of Russian imports in 1913) with a positive trade balance,<sup>25</sup> UK suffered a strong trade deficit.<sup>26</sup> The introduction of modern economy, favored by the newly crowned Tsar Nicholas II in 1894, was largely supported by foreign loans (French and British private subscribers owned ¾ of investments in Russia). Oil and metal extraction increased while large factories were established. Agriculture improved in some regions (Russia became the world fourth producer of textile thanks to high cotton production) but peasants, who represented 80% of the population, remained neglected.<sup>27</sup>

Social and political unrest in factories, countryside and the army throughout the country climaxed in 1905 with the Russian Revolution.<sup>28</sup> The rigid aristocratic government had to

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<sup>16</sup> W.A. McDougall, "Introduction" in *20th-century international relations – politics*; J.P. Parry, *The Rise and Fall of Liberal Government in Victorian Britain*, p. 221

<sup>17</sup> W.A. McDougall, "Introduction" in *20th-century international relations – politics*; H. Kurtz, *The Second Reich: Kaiser Wilhelm II and his Germany*, p. 72

<sup>18</sup> W.A. McDougall, "Introduction" in *20th-century international relations – politics*; D. Moon, *Abolition of Serfdom in Russia: 1762–1907*, pp. 9

<sup>19</sup> Tsar or Czar, derived from Latin Caesar, was the primary title in Russian monarchy from 1547 to 1721. Later, it became subsidiary to Russian Autocrat title.

<sup>20</sup> W.A. McDougall, "Introduction" in *20th-century international relations – politics*; W. Kirchner, *op. cit.*, pp. 225

<sup>21</sup> W. Kirchner, *op. cit.*, pp. 213. Note that Japan was allied to UK since 1902.

<sup>22</sup> R.E. Glatfelter, "Russia, the Soviet Union, and the Chinese Eastern Railway", p. 140; W. Kirchner, *op. cit.*, p. 212

<sup>23</sup> W.A. McDougall, "Introduction" in *20th-century international relations – politics*

<sup>24</sup> R. Muntig, "British business and the politics of trade with the USSR during the New Economic Policy (NEP)", 2006, p. 254

<sup>25</sup> M.R. Dohan, *Soviet Foreign Trade in the N.E.P., Economy and Soviet Industrialization Strategy*, p. 152

<sup>26</sup> R. Muntig, *loc. cit.*

<sup>27</sup> W. Kirchner, *op. cit.*, pp. 217

<sup>28</sup> A. Ascher, *The Revolution of 1905: Russia in Disarray*, p. 202



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stepback back and agree on a constitutional regime on 6 May 1906 with the establishment of the State Duma and a limited multi-party system.<sup>29</sup>

On geopolitical level, Russia gradually moved away from German Empire eventhough the latter was its major trade partner. Russia preferred to ally with France (1891-93 Franco-Russian Alliance agreement) and UK (Convention between the United Kingdom and Russia relating to Persia, Afghanistan, and Tibet signed on 31 August 1907<sup>30</sup>) to create in the end the Triple Entente.<sup>31</sup> In 1910, Russia managed through the Potsdam agreement to extend to Russia the Germany-Turkey Bagdad line and reduce the German influence in Turkey. On the German side, Kaiser Wilhelm II was convinced that an inevitable "racial war, the war of Slavdom against Germandom" would occur in the close future. On 8 December 1912, he postponed plans for war with the Russian Empire but ordered national propaganda against Russia.<sup>32</sup> The latter remained frontly opposed to the Austro-Hungarian Empire in the Balkans (e.g. the 1898 Turko-Greek war, the 1901 Macedonian revolt, the failure of the Buchlau agreement to bargain notably Bosnia-Herzegovina annexion and opening of the Straits of Constantinople to Austrian warships in exchange of Serbian expansion, and the 1912-3 Balkan Wars<sup>33</sup>).<sup>34</sup>

## 2. Disaster of First World War and Twilight of the Romanov

At the outburst of WWI, differences in the population size of the European countries was perceived as a direct threat by the less favored ones. France feared Germany which demographic weight was 67% greater, while the German Empire was concerned by Russia that outnumbered it by 70%. Subsequently, this latter concern was balanced by the backwardness of the Russian army.<sup>35</sup>

According to initial plans, Russia successfully attacked southward the Austrian Galicia where Slavs lived. However, French optimistic offensives faced strong German resistance and thus it was urgently requested that Russia opened a direct second front against the German Empire. Such highly demanding move heavily failed<sup>36</sup> and bled dry the army as well as the economy.<sup>37</sup> Contrary to the other countries involed in the war, Russia had reached its limits in 1917: 10% of the entire population had already been enrolled in the army and more than half was wounded or dead.<sup>38</sup>

The growing political influence of the Tsarina Alexandra over his imperial spouse (especially when he was away supervising the war front) was disapprouved by the nobility and the court. Indeed, such influence was originating from an obscure non-aristocratic adviser, Rasputin, and decisions lacked pertinence in the management of state matters.<sup>39</sup> To protect tsarism, it was decided to murder Rasputin on 30 December 1916<sup>40</sup>. This violent action was in fact insufficient. The discredit was deeper; the Tsar personified all failures: basic food was scarce, corruption became endemic, inflation reached summits, the Tsar occasionally

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<sup>29</sup> W. Kirchner, *op. cit.*, pp. 221

<sup>30</sup> J.A.S. Grenville and B. Wasserstein, *The Major International Treaties of the Twentieth Century*, p. 45

<sup>31</sup> L. Smith, S. Audoin-Rouzeau and A. Becker, *France and the Great War 1914-1918*, p. 12

<sup>32</sup> R.R. McLean, *Royalty and Diplomacy in Europe 1890-1914*, p. 66

<sup>33</sup> L. Albertini, *The Origins of the War of 1914*, 2005, pp. 16; R.C. Hall, *The Balkan Wars, 1912-1913: Prelude to the First World War*, pp. 1

<sup>34</sup> W. Kirchner, *op. cit.*, pp. 227

<sup>35</sup> W.A. McDougall, "Introduction" in *20th-century international relations – politics*

<sup>36</sup> e.g. the 1914 serie of defeats in Tannenberg and Masurian Lakes, the 1915 retreat from the previous conquests and the 1916 Brusilov offensive, which is considered one of the most lethal battles in world history with one million casualties from June to September 1916 (noteworthy the latter offensive helped to divert the German attrition attack at the battle of Verdun on the French front)

<sup>37</sup> W. Kirchner, *op. cit.*, pp. 233

<sup>38</sup> W.A. McDougall, "World War I, 1914-18" in *20th-century international relations – politics*

<sup>39</sup> G. King, *The Last Empress: The Life & Times of Alexandra Feodorovna, Tsarina of Russia*, p. xi; S.J. Lee, *Russia and the USSR, 1855-1991: Autocracy and Dictatorship*, pp. 176

<sup>40</sup> W. Kirchner, *op. cit.*, pp. 235

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dissolved the Duma for arbitrary purposes and additionally he had directly failed on the field as the (unexperienced) military chief of staff.<sup>41</sup> It was the twilight of the 300 year-old Romanov dynasty.

### 3. End of World War I and 1917 Russian Revolution

Severe cold and bread riots on 8 March 1917 (O.S. 23 February)<sup>42</sup> in Petrograd (previously named St Petersburg until 1914) were the spark of a spontaneous revolution, i.e. the February Revolution. Then, the unrest contaminated some local troops that joined the protesters. The Tsar, who was away from the capital, misinformed and convinced that the situation was under control, ordered the local garrison to stop the few remaining demonstrators. On 11 March 1917, a regiment refused to fire on the protesters. As an immediate response, Nicholas II suspended the Duma. The following day, mutiny started in most of the local regiments, and members of the former Duma allied with the novel Petrograd Soviet (i.e. council) of Workers' and Soldiers' Deputies (which originated from factories and the ranks of the army around Petrograd) formed a Provisional Government. The Tsar was immediately asked to abdicate. To reduce the tension, Nicholas II did so on 15 March 1917 in favor of his brother, the Grand Duke Michael Alexandrovich of Russia. The latter was reluctant and subsequently agreed to take over only under the condition that an elected assembly ratified it (which never occurred).<sup>43</sup>

The unprepared Provisional Government, lead at the beginning by the moderate "Progressive block" of the former Duma, was initiated in order to organize elections to the Russian Constituent Assembly and its convention. But such organization was delayed as some political forces, such as the Bolsheviks<sup>44</sup>, had a different agenda and favored revolution without any democratic transition. The Petrograd Soviet grew in political influence within the government. On March 14, the real power obviously switched to the Soviet: its Order No. 1 (i.e. soldiers had to obey only orders from the Soviet and not those from the Provisional Government) was applied. To avoid a conservative coup, the Soviet decided to not join the Government. By doing so, the Soviet influence was undiluted and remained present: The "bourgeois" ministers disappeared and the successive coalition governments (lead by the Socialist Revolutionary Alexander Fyodorovich Kerensky) were more and more destabilized until October 1917.<sup>45</sup>

Over its short existence, the weak Provisional Government managed to reach some achievements; it restored the constitution of Finland, declared the independence of Poland, established local government on a universal suffrage basis, conceded language rights to all the nationalities, abolished capital punishment and confirmed liberty of speech, assembly and of the press.<sup>46</sup> The US President Wilson supported the Russian political change and USA officially recognized the Provisional Government on 22 March 1917 while UK, France and Italy did so two days later. Note that even though the state was *de facto* a Russian Republic at the Tsar abdication, it became officially so only on 16 September 1917 under the transitory Directorate<sup>47</sup> (which dissolved at the same time as the State Duma of the Russian Empire).<sup>48</sup>

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<sup>41</sup> Editors of Encyclopædia Britannica, *Russian Revolution of 1917*; W.A. McDougall, "World War I, 1914-18" in *20th-century international relations – politics*

<sup>42</sup> 8 March 1917 was the International Women's Day and took place in Petrograd the Women's demonstration for bread and peace, which was initiated by female textile workers.

<sup>43</sup> R. Crawford and D. Crawford, *Michael and Natasha: The Life and Love of the Last Tsar of Russia*, pp. 312

<sup>44</sup> Literally meaning "one of the majority". Bolsheviks (founded by Vladimir Ilyich Ulyanov, alias Lenin, and Alexander Bogdanov) were the alleged "majority" faction of the Marxist Russian Social Democratic Labour Party, which split apart from the so-called "minority" Menshevik faction at the Second Party Congress in 1903.

<sup>45</sup> Editors of Encyclopædia Britannica, *Russian Revolution of 1917*

<sup>46</sup> H.W. Williams, *The Spirit of the Russian Revolution*, p. 9

<sup>47</sup> The Directorate made the transition from the collapse of the Second Provisional Government on 14 September 1917 to the Third Provisional Government on 8 October 8 1917, to resolve the Kornilov Affair (refer to the next paragraph for explanation).

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The unstable conditions gradually favored the Bolsheviks. On 9 April 1917, Germans facilitated the transfer of Vladimir Ilyich Ulyanov, alias Lenin, and other Russian dissidents from Zürich to Petrograd.<sup>49</sup> In May 1917, Lev Davidovich Bronstein, alias Leon Trotsky, arrived from USA.<sup>50</sup> In July 1917, Bolsheviks (including Leon Trotsky) were arrested and blamed for supporting demonstrations. Lenin accused of being a German agent provocateur had to hide and flee. The Bolsheviks used to a long practice of clandestinity managed to maintain their organization and determination compared to the several other novel political forces. In August 1917, some forces favored the Commander-in-chief of Russian army Lavr Kornilov as a potential dictator (the so called Kornilov Affair). As troops converged to Petrograd, the Provisional Government found itself powerless. Minister-President Kerensky asked for support from the Petrograd Soviet, it further ordered the release of Bolshevik political prisoners and provided them with arms (that they never returned). The presence of the Bolshevik military organization, the Red Guards, stopped the advance of the army. Soviets and Bolsheviks gained legitimacy as well as prestige (the pro-Bolshevik Leon Trotsky was elected leader of the Petrograd Soviet and Lenin safely returned to Petrograd).<sup>51</sup> By September 1917, the Bolsheviks with their temporary allies, the Left Socialist Revolutionaries of Maria Alexandrovna Spiridonova (who split from the Socialist Revolutionaries as they refused to support the Provisional Government), had overtaken the Socialist Revolutionaries of Alexander Fyodorovich Kerensky and the Mensheviks of Julius Martov (both being part of the coalition governments). At that time, Bolsheviks held majorities in both the Petrograd and Moscow Soviets.<sup>52</sup> Finally, in November 1917, the political programme of Lenin about peace, land, and bread attracted strong popular interest:

*To All Workers, Soldiers and Peasants. The Soviet authority will at once propose a democratic peace to all nations and an immediate armistice on all fronts. It will safeguard the transfer without compensation of all land – landlord, imperial, and monastery – to the peasants' committees; it will defend the soldiers' rights, introducing a complete democratisation of the army; it will establish workers' control over industry; it will ensure the convocation of the Constituent Assembly on the date set; it will supply the cities with bread and the villages with articles of first necessity; and it will secure to all nationalities inhabiting Russia the right of self-determination... Long live the revolution!*<sup>53</sup>

On 6 November 1917 (O.S. 24 October 1917), Bolsheviks supported by Left Socialist Revolutionaries occupied strategic buildings and the next day captured the Winter Palace, seat of the Provisional Government. During this so-called October Revolution, power was seized in two days with limited casualties. The world's first socialist state was created but it officially became the Soviet Russian Republic only on 25 January 1918 at the third meeting of the All-Russian Congress of Soviets.

Bolshevik control proved to be challenged. The long-awaited Constituent Assembly elections, held on 12 November 1917, saw the Socialist Revolutionaries as first party (370 seats) and Bolsheviks only second (175 seats) out of the 715 seats of the legislative body. To slow the process of the Constituent Assembly, Bolsheviks postponed the opening session from 28 November 1917 to 5 January 1918. Subsequently, as on the first (and only) session the legislative body rejected the Soviet decrees on peace and land, the Congress of Soviets reacted by dissolving the next day the Constituent Assembly.<sup>54</sup> The constitution was only adopted on 10 July 1918 under Bolshevik control. The state thus became the Russian Socialist Federative Soviet Republic (RSFSR), the world's first constitutionally socialist state with communist ideology.

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<sup>48</sup> Editors of Encyclopædia Britannica, *Russian Revolution of 1917*

<sup>49</sup> C. Rice, *Lenin: Portrait of a Professional Revolutionary*, pp. 139; R. Service, *Lenin: A Biography*, pp. 255

<sup>50</sup> I. Smith, *Leon Trotsky: In a concentration camp in Nova Scotia*

<sup>51</sup> R. Pipes, *The Russian Revolution 1899-1919*, p. 465; C. Read, *Lenin: A Revolutionary Life*, p. 174

<sup>52</sup> R. Pipes, *op. cit.*, p. 471; C. Read, *op. cit.*, p. 180

<sup>53</sup> C. Rice, *op. cit.*, p. 161

<sup>54</sup> J. Llewellyn, J. Rae and S. Thompson, *The Constituent Assembly*, p. 1

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Concerning the international relations, foreign trade quickly became a state monopoly.<sup>55</sup> In addition to this anti-capitalistic measure, the Bolshevik Red Terror scared the capitalist Western countries to the point that diplomatic missions and even the Red Cross broke contact while a cordon sanitaire was created around RSFSR's borders in autumn 1917. Indeed, on the night of 16-17 July 1918, Nicholas II and his family were executed. And in August 1918, the Cheka (the Soviet state security organization created on 20 December 1917 by a decree of Lenin) arbitrarily detained 200 British and French citizens in Moscow<sup>56</sup>, illegally entered in their consulates, and murdered the British naval attaché.<sup>57</sup> Most foreign experts and many Russian specialists fled to the countryside or abroad. Thus several businesses lost their skilled workers. Lack of fuel proved to shake the survival of many companies, as their small size did not allow any anticipation. Moreover, a decree from the Soviet Commissariats of Labour and War on 21 December 1917, which obliged a switch from war to peacetime production within a month, did not allow any adaptation period and as a result many enterprises were forced to close. Commercial activities in most sectors dropped to less than 5% in 1922 compared to levels prior to the 1917 Revolution. Inflation led to payment in kind and stimulated local self-sufficiency.<sup>58</sup>

From October 1917 to January 1918, further radical changes occurred as all domains of society were considered political, including economy. Banking was declared a state monopoly while all tsarist prewar loans were declared null and void. Separation of church and state was instituted. Only civil marriages were legally recognized, and divorce by petition of one or both parties was made possible. Main real estate of church, state and private owners were confiscated, and Russian factories were gradually nationalized (only 100 and 400 firms were respectively controlled by the central government and local authorities by July 1918). All mines were declared public property and all foreign trade nationalized. Work was limited to 8 hours per day while women, children and mine workers gained further protection. Social insurance and price regulation were introduced. Social classes were abolished. The (Red) army was reorganized and censorship imposed. The promise to allow self-determination to the peoples led to the independence of Finland, Polish Bessarabia, Caucasus region, and later Estonia, Latvia and Lithuania.<sup>59</sup>

Bolsheviks initially planned to promote socialist internationalism but the revolution proved already weak in Russia. Peace at the borders was necessary to concentrate efforts on the internal conquest and stabilization of the country; expansion could be launched later. Thus it was decided in November 1917 to initiate separate armistice negotiation with the Central Powers, i.e. Germany, Austria-Hungary, Bulgaria, and the Ottoman Empire. On 15 December 1917, an armistice was concluded. Lenin was in favor of immediately signing a peace treaty but the majority of the Bolshevik Central Committee, led by Trotsky, disagreed, considering that the revolution was ready to spread in all the Central Powers.<sup>60</sup> To pressure the Bolsheviks, the Central Powers resumed attacks on 18 February 1918, and quickly seized most of the territories that were debated during the previous negotiations. Moreover, the German government managed to control its internal revolutionary agitators (who were stimulated by the Russian revolution) and a German fleet approached Petrograd. The majority of the Bolshevik Central Committee had no choice to accept the new (harsher) conditions of the Treaty of Brest-Litovsk on 3 March 1918. Soviet Russia owed six billion marks to Germany in compensation to repudiation of Tsarist bonds and nationalisation of German assets in Russia. Additionally, it had to turn over notably to Germany 34% of its population, 32% of farmland, 54% of industrial plants, 89% of coalmines, and virtually all of its cotton and oil

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<sup>55</sup> R. Muntig, *op. cit.*, p. 258

<sup>56</sup> The RSFSR government moved to Moscow (at the Kremlin) in March 1918

<sup>57</sup> W.A. McDougall, "Peacemaking 1919-22" in *20th-century international relations – politics*

<sup>58</sup> A.C. Sutton, *op. cit.*, pp. 311

<sup>59</sup> M. Dobb, *Russian Economic Development Since the Revolution*, pp. 25; W. Kirchner, *op. cit.*, pp. 242

<sup>60</sup> R. Fischer, *Stalin and German Communism: A Study in the Origins of the State Party*, p. 39

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fields.<sup>61</sup> Russia also renounced claims on Estonia, Latvia, Lithuania, Belarus and Ukraine; it further confirmed the independence of Finland. Finally, Turkey was to regain the territories lost during the Russo-Turkish war of 1877-1878.<sup>62</sup>

#### 4. Russian Civil War (November 1917 - October 1922)

UK and France were desperate to maintain the Eastern front against Germany. They organized a trade blockade to avoid supplies falling into German hands<sup>63</sup> and sent (later on with the additional support of USA) a limited joint task force to Murmansk and Arkhangelsk arctic harbours in March and September 1918 with the consent of the local soviet.<sup>64</sup> Such reduced force<sup>65</sup> was not intended to overthrow the Bolshevik regime but to attract opposing Russian counter-revolutionary forces.<sup>66</sup>

Indeed, Allies feared a possible Russo-German alliance, a Soviet Russian default on Imperial Russia's massive foreign loans and a global contamination of Communist revolutionary ideas.<sup>67</sup> To try to divide the front, Lenin instructed the foreign affairs Commissar Georgy Chicherin to advocate in vain the right of Russian people's self-determination before the US president Thomas Woodrow Wilson, who had promoted on 8 January 1918 his principles for peace in fourteen points.<sup>68</sup>

The fight for power led to chaos; the country was divided in regions under different influences. While Bolsheviks or "Reds" controlled Petrograd, Moscow, and the industrial regions of Russia, White forces (a loose alliance favoring monarchism, capitalism and alternative forms of socialism, each with democratic and anti-democratic variants) remained uncoordinated with troops in Omsk (southwestern Siberia) and Odessa (northwestern shore of the Black Sea) under the command of Admiral Aleksandr Kolchak and General Anton Denikin respectively. To complexify the situation, some Green armies made of rival socialists and non-ideological forces fought against both the Reds and the Whites.<sup>69</sup>

By 1919, the main White forces were defeated by the Red Army<sup>70</sup> (under the command of Leon Trotsky) and its harsh war communism principles (notably *Prodrazvyorstka*, the confiscation of agricultural produce for a low nominal fixed price according to specified quotas). In late 1920, the remaining White forces in Crimea, commanded by Pyotr Nikolayevich Wrangel, had to evacuate. Furthermore, the Red Army led to the creation of the "autonomous" federation of Communist regimes in Georgia, Armenia, and Azerbaijan. Then, fighting remained limited to the Far East and ended in 1923.<sup>71</sup>

On top of the war terror, the Russian people, especially in the Volga and Ural River regions, suffered from a severe famine (named *Povolzhye* famine) from spring 1921 to the end of 1922. *Prodrazvyorstka* (see above paragraph) combined to drought led to national catastrophe with an estimation of 5 million deaths. Noteworthy, as private trade had been declared illegal and resources limited, economy fell back to barter. Wages of workers were

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<sup>61</sup> W.A. McDougall, "World War I, 1914-18" in *20th-century international relations – politics*; J. Keegan, *The First World War*, p. 342; W.L. Shirer, *The Rise and Fall of the Third Reich*, p. 57

<sup>62</sup> Avalon Project, *Foreign Relations of the United States: 1918 - The Conclusion of the Peace of Brest Litovsk*

<sup>63</sup> R. Muntig, *op. cit.*, p. 258

<sup>64</sup> After a number of clashes with the Red army, such Allied forces reembarked from Arkhangelsk on 30 September 1919 and Murmansk on 12 October 1919.

<sup>65</sup> Western countries had no support from their war-weary populations and too limited financial resources.

<sup>66</sup> W.A. McDougall, "Peacemaking 1919-22" in *20th-century international relations – politics*

<sup>67</sup> Editors of Encyclopædia Britannica, *Russian Civil War*

<sup>68</sup> W.A. McDougall, "Peacemaking 1919-22" in *20th-century international relations – politics*; Avalon Project, *President Woodrow Wilson's Fourteen Points*

<sup>69</sup> Editors of Encyclopædia Britannica, *Russian Civil War*

<sup>70</sup> Note that ranks were abolished and officers were elected by the troops.

<sup>71</sup> W.A. McDougall, "Peacemaking 1919-22" in *20th-century international relations – politics*

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paid largely in kind through the direct distribution of products or food rations.<sup>72</sup> Aliments were thus a central matter. As a response to such tragedy, international humanitarian interference was organized with provision of food supply mainly by the American Relief Administration (headed by the United States Secretary of Commerce and future US president Herbert Clark Hoover) and International Committee of the Red Cross.<sup>73</sup> Such approach was not selfless; Allies used this strategy as an attempt to seduce the Russian people when fighting against the Reds had failed to reach expectations. On the Soviet side, Lenin refused Russian transports to be placed at the disposal of an Allied commission, as it would have meant *de facto* Allied control of Russia.<sup>74</sup> Lenin used the famine as a tool to blame the Orthodox Church and decrease its influence on the population.<sup>75</sup> Moreover, the government faced a difficult dilemma, as resources were very limited and war everywhere. In the end, the government chose material instead of food supply. As an example, it costed 220 million gold roubles from 1920 to 1924 to (i) get the crucial foreign railway equipment, such as the British Armstrong-Whitworths locomotives, to (ii) replace the high number of destroyed trains and tracks, and to (iii) support the key mobility of the Red army and trade. Such amount of roubles absorbed 30% of all 1920 reserves, exhausted more than half of the gold reserves by 1922 and far exceeded the 20 million cost of the famine relief.<sup>76</sup>

At the borders, not only the Allies pressured the Reds. On 18 March 1921, the Treaty of Riga ended the Polish-Soviet war<sup>77</sup> and acknowledged the splitting of Belarus and Ukraine between the Republic of Poland and Soviet Russia.<sup>78</sup> Similar conflicts occurred with the newly established Republics of Finland (Treaty of Tartu on 14 October 1920)<sup>79</sup>, Estonia (Tartu Peace Treaty on 2 February 1920)<sup>80</sup>, Latvia (Latvian-Soviet Peace Treaty on 11 August 1920)<sup>81</sup>, and Lithuania (Soviet-Lithuanian Peace Treaty on 12 July 1920)<sup>82</sup>.

Soviet Russia quickly identified the need for foreign investment and technological support. As early as December 1917, the first All Russian Congress of Councils of the National Economy promoted this option. In May 1918, the same institution suggested the opening of foreign concessions. On his side, Peoples' Commissar for Foreign Trade Leonid Krasin (ex-director of Siemens-Schukert AG in Petrograd who turned revolutionary) tried to suggest long-term foreign loans considering that it could faster affect the trade balance but it proved to be politically unacceptable.<sup>83</sup> In addition, concessions contrary to loans allowed technology transfer. However, Civil War cancelled negotiations. In 1920, Lenin considered the situation stable enough to issue a decree allowig governmental departments to grant concessions. However, other members of the ruling communist party were reluctant, as it was perceived as an internal pro-capitalist measure. Furthermore, it was against the planning of international

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<sup>72</sup> A. Nove, *An Economic History of the USSR*, p. 55

<sup>73</sup> N. Lowe, *Mastering Twentieth-Century Russian History*, p. 155; A. Nove, *op. cit.*, p. 62

<sup>74</sup> W.A. McDougall, "Peacemaking 1919-22" in *20th-century international relations – politics*

<sup>75</sup> R. Pipes, *Russia under the Bolshevik regime 1919-1924*, p. 415

<sup>76</sup> R. Muntig, *op. cit.*, p. 258; A. Heywood, *Modernising Lenin's Russia*, p. 85; H. Carlback-Isotalo, "Ekonomicheskie svyazi sovetskoi Rossii i Shvetsii 1917-1924", p. 36

<sup>77</sup> K. Marek, *Identity and Continuity of States in Public International Law*, 1968, pp. 419; The Treaty of Riga was agreed between Poland, Russian SFSR (acting also on behalf of Belarus SSR) and Ukrainian SSR. Note that on 25 April 1920, Polish army ambitioned to create a grand Polish-Lithuanian-Ukrainian empire and in the end partially succeeded as they managed to extend their territory.

<sup>78</sup> J. Zaprudnik, *Belarus: at a crossroads in history*, p. 75.; J. Borzęcki, *The Soviet-Polish Peace of 1921 and the Creation of Interwar Europe*, pp. 220

<sup>79</sup> R. Alapuro, *State and Revolution in Finland*, p. 167

<sup>80</sup> G. von Rauch, *The Baltic States: The Years of Independence 1917-1940*, p. 73

<sup>81</sup> M.M. Laserson, "The Recognition of Latvia", pp. 234

<sup>82</sup> A. Eidintas, V. Žalys and E. Tuskenis, *Lithuania in European Politics: The Years of the First Republic 1918-1940*, pp. 85

<sup>83</sup> E.H. Carr, *Socialism in One Country 1924-1926*, p. 472

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revolution exportation (notably in Germany and to a lower extent the UK). On the other hand in UK while businessmen were attracted to the new Russian market, the administration remained opposed to communism.<sup>84</sup> As a consequence, the first concession attempt with Urquhardt, a major British financier, failed.<sup>85</sup>

Political positions slowly evolved in UK. On 14 January 1920, four days after the ratification of the Treaty of Versailles, liberal Prime Minister Lloyd George suggested at a meeting of the Allied Supreme Council to stop the Russian blockade as WWI had ended. Russia was too important to be isolated; it could help balancing the German power in the future. To create the illusion of a trade specific agreement, the Russian party was supposed to be the All-Russian Union of Consumer Co-operative Societies *Centrosoyuz*, instead of the RSFSR government. The Bolsheviks identified the offer as strategic and Lenin through the Council of People's Commissars accepted it by promulgating an executive decree on 27 January 1920. Commissar Leonid Krasin, considered anglophile, was sent in May 1920 to London and to maintain the trade union illusion he was coopted on the board of *Centrosoyuz*.<sup>86</sup> As the other Allies refused to join the UK approach, the Anglo-Soviet Trade Agreement was signed on 16 March 1921.<sup>87</sup> *De facto*, it brought invaluable international recognition of the Soviet regime, while UK had no immediate commercial gain.<sup>88</sup> Indeed, RSFSR was viewed from the West as a solution to industrial stagnation and unemployment while in reality the Russian market was controlled by a state monopoly.<sup>89</sup>

### **5. New Economic Policy (21 March 1921 - 1928)**

Even though RSFSR survived WWI and the Civil War, the country lost Poland, Finland, the Baltic states and Bessarabia. The Communist revolution failed to spread and the state was surrounded by hostile foreign governments, which had different norms of international relationship.<sup>90</sup> Internally, the country and its economy were in lamentable state of affairs. As revolutionary plan did not include operation of a socialist economy, limited foresight, coordination and funds led to major wastage of the existing reduced resources. Moreover, foreign technology transfer was not optimized as government lacked reference and expertise to grant contracts. For example, some local plants were not ready or adapted to the imported types of machine tools; local redundant and uncoordinated administrations delayed acceptance of foreign experts' visas for unclear reasons.<sup>91</sup> In addition, peasant uprisings strongly criticized the forced seizure of grain crop and worker strikes reacted against the reduction of bread rations. On 28 February 1921, the Kronstadt rebellion went as far as the creation of its own Provisional Revolutionary Committee and the publication of the *Petropavlovsk* resolution that raised 15 demands related to freedom.<sup>92</sup>

In this context, the country had to be internally reorganized. Furthermore, its international policy needed to be redefined to pursue regular relations with foreign powers and in the end attract capital, trade and technology for reconstruction. The Bolshevik revolutionary movement, which was initially a minority faction of a minority party, had to mature into a functioning state (under the dictates of the Communist Party).

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<sup>84</sup> A. Heywood, *Modernising Lenin's Russia*, 1999, p. 85

<sup>85</sup> A.C. Sutton, *op. cit.*, p. 6

<sup>86</sup> M.V. Glenny, "The Anglo-Soviet Trade Agreement, March 1921", pp. 63.

<sup>87</sup> Annex 5 - Trade Agreement Between His Britannic Majesty's Government and the Government of the Russian Socialist Federal Soviet Republic, 16 March 1921

<sup>88</sup> R. Muntig, *op. cit.*, p. 258; C.A. White, *British and American Commercial Relations with Soviet Russia 1918-1924*, p. 227

<sup>89</sup> W.A. McDougall, "A fragile stability, 1922-29" in *20th-century international relations – politics*

<sup>90</sup> W.A. McDougall, "Peacemaking 1919-22" in *20th-century international relations – politics*

<sup>91</sup> A.C. Sutton, *op. cit.*, p. 323

<sup>92</sup> P. Avrich and P.A. Kropotkin, *The Anarchists in the Russian Revolution*, 1973, pp. 163. From 7 to 19 March 1921, the Red Army successfully fought to retake control of the Kronstadt naval fortress, base of the Russian Baltic Fleet, on Kotlin Island at only 55 kilometres from Petrograd. Thousands of soldiers and civilians were killed in the attack.

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According to the recommendation of Commissar Krasin, Lenin decided by decree on 21 March 1921<sup>93</sup> to replace War Communism by the New Economic Policy (NEP) in order to reach Western levels in the shortest possible time and thus achieve complete self-sufficiency.<sup>94</sup> This temporary shift from pure communism policy was not to restore capitalism but to adapt it to socialist society.<sup>95</sup> Lenin ordered to divide industrial companies in two groups. On one hand, large functioning state-operated institutions and on the other hand the entities leased to private individuals and foreigners.<sup>96</sup> Furthermore, indebted companies had to be abandoned while the others were to desperately receive foreign technical assistance and capital but under Soviet supervision.<sup>97</sup> Such deviation from the initial revolutionary line was not understood by the lower ranks of the Communist Party, Cheka (which became OGPU in 1923) and bureaucracy.<sup>98</sup> To keep the support of the people, the government had thus to explain without any disguise the final aim of this plan: *Of course we need bourgeois specialists for a short time. As soon as Party members learn what these specialists know we'll get rid of the specialists fast enough. Right now we must treat and feed them far better than ourselves; but their time will come, just as it did for the rest of the bourgeoisie.*<sup>99</sup>

Initially, the government had no economic knowledge. Measures, such as 'free' transport and arbitrary doubling-tripling of wages, quickly exhausted the finances. In parallel, absence of production incentives led to demobilization and massive decline in labour productivity. Finally, successive campaigns to devalue the ruble and its associated currencies (various forms of imperial ruble, *kerenki* and *sovznaki*) fed a spiralling hyperinflation (at some point, bank note rubles were only printed on one side).<sup>100</sup> In early 1922, as a drastic measure, the People's Commissariat for Finance (*Narkomfin*) decided to redefine the currency rate: 1 "new" ruble was worth 10,000 "old" rubles. In parallel, the gold-backed *chervonet* currency was introduced.<sup>101</sup> Paper form was used for domestic circulation while gold coins secured international payments and consequently stimulated the NEP. By the end of 1922, annual industrial production increased by 30%.<sup>102</sup> The ruble value was increased a third time in early 1923 at a rate of 100 to 1 and on 22 February 1924 gold ruble replaced the "third" ruble at a rate of 50,000 to 1.<sup>103</sup> Such changes supported the improvement of the NEP period. However, price calculation and wage payments remained chaotic (at the disadvantage of workers), as the State Planning

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<sup>93</sup> NEP initial measures were adopted at the 10<sup>th</sup> Congress of the All-Russian Communist Party and promulgated by the "On the Replacement of *Prodrazvyorstka* by *Prodnaolog*" decree on 21 March 1921. Forced grain requisition (*prodrazvyorstka*), which was adopted in June 1918, was replaced by a tax on farmers that was payable in the form of raw agricultural products (*prodnaolog*).

<sup>94</sup> W.A. McDougall, "A fragile stability, 1922–29" in *20th-century international relations – politics*

<sup>95</sup> *Krasnya Gazeta*, Petrograd, 20 December 1921

<sup>96</sup> *Krasnya Gazeta*, Petrograd, 13 August 1921

<sup>97</sup> *Krasnya Gazeta*, Petrograd, 26 January 1922; A.C. Sutton, *op. cit.*, p. 316

<sup>98</sup> A.C. Sutton, *op. cit.*, p. 308

<sup>99</sup> Quote of a speech of Kopylov, a collective farm chairman, at Tikhonova Pustyn in the Kaluga province; V.N. Ipatieff, *The life of a chemist: memoirs of Vladimir N. Ipatieff*, Stanford University Press, Stanford, 1946; Ipatieff, Professor of Chemistry and Explosives at the University of St. Petersburg/Petrograd and General-Lieutenant of the Russian army, fled Soviet Russia in 1930. Note that the Tsar family was imprisoned in a house seized from the Ipatieff family in Ekaterinburg when the Bolsheviks decided to execute the imperial family. Moreover note that the American Chemical Society awards every three years the Ipatieff Prize that honors outstanding experimental work in the field of catalysis or high-pressure chemistry by researchers under the age of 40.

<sup>100</sup> A.C. Sutton, *op. cit.*, p. 310

<sup>101</sup> *Chervonet* derives from *chervonnaye zoloto*, which means pure gold. Chervonet gold coins contained 8.6 grams of 0.900 alloy, i.e. 900‰ purity or also defined as 21.60 carats.

<sup>102</sup> N.E. Kredins, "Monetary reforms in the USSR of 1922-1924 and 1947" (article in Russian), Moscow, 2001, pp. 3

<sup>103</sup> A. Nove, *op. cit.*, pp. 54; M. Dobb, *Russian Economic Development Since the Revolution*, pp. 25; N.E. Kredins, "Monetary reforms in the USSR of 1922-1924 and 1947" (article in Russian), pp. 3; J.E. Pickersgill, "Hyperinflation and Monetary Reform in the Soviet Union 1921-26", pp. 1037



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Committee (Gosplan) used a pre-war ruble of its own creation for implementing many Soviet contracts.<sup>104</sup>

On the international scene, RSFSR proved to have little influence during the 1921 Åland crisis between Finland and Sweden even though such islands used to be Russian from 17 September 1809 to the auto-proclaimed independence of Finland on 6 December 1917.<sup>105</sup>

In 1922, Allies tried to reintegrate RSFSR in the diplomatic world. On 6 January 1922, while the Cannes Conference (a WWI Supreme War Council at the initiative of UK Prime Minister Lloyd George) granted to Germany a delay in making upcoming reparations payments, it also offered an invitation to RSFSR to participate at the future Genoa Economic and Financial Conference (from 10 April to 19 May 1922).<sup>106</sup> RSFSR positively accepted the invitation as it repeatedly suggested economic cooperation. The clauses offered at the Cannes conference and detailed at the Genoa conference appeared unacceptable. Clause 1 stated that parties accepted the right to choose for itself the system it preferred (which meant that capitalism and communism were equally accepted) but in parallel parties had to limit propaganda and interference with internal affairs of other countries. '*To ask the Soviet regime in its weakness to refrain from making use of its revolutionary tools was as futile as to ask the British Empire to scrap its fleet*'.<sup>107</sup> The following articles requested the Soviet government to guarantee foreign capital and property, and recognize all private debts and obligations of the former governments.<sup>108</sup> RSFSR only agreed to reconvene at the Hague international financial and economic conference. Thus, the Genoa Conference succeeded only on the rebuilding plan of Central/Eastern Europe.<sup>109</sup> The conference also decided on the partial return to the Gold Standard, which was abandoned during WWI.<sup>110</sup> This Gold Bullion Standard or Inter-war Gold Standard was to secure international trade; central banks kept gold reserves in their vaults while day-to-day transactions used paper notes (contrary to the pre-war Gold Coin Standard).<sup>111</sup>

As Germany and RSFSR quickly realized that (i) the Genoa Conference would not provide them with significant positive outcome and that (ii) both countries had common interests (notably against the recently expanded borders of Poland), the two delegations decided to

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<sup>104</sup> E.H. Carr, *A history of Soviet Russia: the Interregnum 1923-1924*, p. 69

<sup>105</sup> S. Spiliopoulou-Åkermark, *The Åland islands in the League of Nations: The ideal minority case?*, Redescriptions - Finnish Yearbook of Political Thought, pp. 198; Council of the League of Nations on the Åland islands, *Decision of the Council of the League of Nations on the Åland islands including Sweden's protest*. The Åland crisis was one of the first litigations arbitrated by the recently created League of Nations (on 10 January 1920). The Ålandic islanders of Swedish culture at 90% did not manage to obtain full self-determination but secured autonomy from Finland. RSFSR (which became a member, as USSR, only on 18 September 1934), supported self-determination at that time but later USSR (like Nazi Germany) considered annexion of these strategic islands.

<sup>106</sup> Editors of Encyclopædia Britannica, *Cannes Conference*; J.-R. Bézias, "La conférence de Cannes: Diplomatie et Côte d'Azur (janvier 1922)", pp. 15; J.S. Mills, *The Genoa Conference*, pp. 315. Note that Benito Amilcare Andrea Mussolini (elected since 1921 at the Italian Chamber of Deputies) attended the Cannes conference as the director of the Italian newspaper *Popolo d'Italia*, and took this opportunity to strengthen his political contacts and then become Italian Prime Minister on 31 October 1922.

<sup>107</sup> Illustrative quote from the historian T.H. von Laue; T.H. von Laue, "Soviet Diplomacy: G.V. Chicherin, Peoples Commissar for Foreign Affairs 1918-1930", *The Diplomats 1919-1939*, p. 246

<sup>108</sup> J.S. Mills, *op. cit.*, pp. 201 and 226

<sup>109</sup> Editors of Encyclopædia Britannica, *Conference of Genoa*

<sup>110</sup> S.V.O. Clarke, "The Reconstruction of the International Monetary System: The Attempts of 1922 and 1933", pp. 12. Note that, contrary to the other nations, the countries having a gold-convertible currency were not impacted by a negative balance of international trade to be paid in their respective currencies, as their gold stocks were not impacted. With this system, USA notably became indebted up to 350% of its GDP, which contributed to the 1929 Great Depression. In addition, note that Gold Bullion Standard suppressed international interest in the Soviet chervonets. They were thus withdrawn from foreign payments in 1930. To get much-needed foreign currency, USSR struck and circulated abroad millions of 10 and 5 ruble coins in the pre-revolutionary design.

<sup>111</sup> L. Pasvol'sky, "The Gold Standard before and after the War", pp. 171.

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meet at Rapallo in parallel to the Genoa Conference. On 16 April 1922, the so called Treaty of Rapallo was signed in Rapallo, ratified in Berlin on 31 January 1923 and registered in the League of Nations Treaty Series on 19 September 1923. Firstly, as an extension of the Treaty of Brest-Litovsk, each country renounced all territorial and financial claims against the other. Germany renounced compensation for nationalization of properties in RSFSR provided that the latter would not satisfy similar claims of other governments. In addition, they agreed to normalise their diplomatic relations and to collaborate in the economic field.<sup>112</sup> Secret cooperation was subsequently discussed to support strengthening of the Red army in exchange of permission to perform German military research on Russian soil (in violation of the imposed conditions of the WWI peace treaties).<sup>113</sup>

The follow-up of the Genoa conference, The Hague conference, was held from 15 June to 19 July 1922. Discussions focused on the Russian securities to potential large credits and the claims of capitalist countries (excluding Germany) against the Soviet government, i.e. compensation of (i) the nationalization of the property of foreign capitalists and (ii) the repudiation of the debts of the tsarist and provisional governments. As positions were irreconcilable, no agreement was reached.<sup>114</sup>

On 25 October 1922, Japanese troops (which had used the Brest-Litovsk treaty as a pretext to occupy Vladivostok in April 1918) were forced to withdraw under US pressure. While Japanese expansionism was slowed down for a limited time, all foreign interventions in RSFSR went to a close.<sup>115</sup>

On 30 December 1922, the Union of Soviet Socialist Republics (USSR) came into existence by treaty. At the First Congress of the Soviets of the USSR, RSFSR united with the satellite Ukrainian Soviet Socialist Republic, Byelorussian Soviet Socialist Republic and Transcaucasian Soviet Federal Socialist Republic (embracing Azerbaijan, Armenia and Georgia). USSR creation appeared as a major political division (the Georgian Affair) between Lenin and his future successor Joseph Vissarionovich Stalin who favored the merge of Caucasian states into RSFSR.<sup>116</sup> Such treaty was subsequently included in the Soviet Constitution of 31 January 1924 at the Second Congress of the Soviets of the USSR.<sup>117</sup>

In UK, the conservative Andrew Bonar Law replaced Lloyd George as British Prime Minister on 23 October 1922, and was less favourable to RSFSR. On 23 May 1923 he had to resign because of terminal throat cancer but the next Prime Minister Stanley Baldwin (1<sup>st</sup> Earl Baldwin of Bewdley) followed the same policy. On 11 July 1923, Foreign Secretary Lord Curzon (George Nathaniel Curzon, 1<sup>st</sup> Marquess Curzon of Kedleston) sent a note to RSFSR government accusing it of trade agreement breaches (notably blaming Comintern<sup>118</sup> for anti-British agitation in India and spying), and threatening to suspend the 1921 Anglo-Soviet Trade Agreement. Commissar Krasin came back to London to settle the case and trade resumed.<sup>119</sup>

Regarding the Soviet-German relationships, bonds were further tightened. To reinforce the 1922 Rapallo agreement, the treaty was extended to Soviet republics of Ukraine, Belarus,

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<sup>112</sup> Avalon Project, *German-Russian Agreement, April 16, 1922 (Treaty of Rapallo)*; W.A. McDougall, "A fragile stability, 1922–29" in *20th-century international relations – politics*; A.C. Sutton, *op. cit.*, p. 316

<sup>113</sup> G.H. Mueller, "Rapallo Reexamined: A New Look at Germany's Secret Military Collaboration with Russia in 1922", pp. 110; W.A. McDougall, "A fragile stability, 1922–29" in *20th-century international relations – politics*, 2016; A.C. Sutton, *op. cit.*, p. 316; H.W. Gatzke, "Russo-German Military Collaboration during the Weimar Republic", pp. 565

<sup>114</sup> The Spectator, London, 14 July 1922, p. 2; Department of foreign affairs, *Conference at The Hague: June 26–July 20, 1922, minutes and documents*, The Hague Government Printing Office

<sup>115</sup> W.A. McDougall, "Peacemaking 1919–22" in *20th-century international relations – politics*

<sup>116</sup> R. Service, *Lenin: A Biography*, pp. 452

<sup>117</sup> W.A. McDougall, "Peacemaking 1919–22" in *20th-century international relations – politics*

<sup>118</sup> Abbreviation of Communist International, also known as Third International (1919–1943), which was an international communist organization promoting world communism. Note that most European Socialists rejected Communists' violent tactics, Lenin's dictatorship, or both. Thus, Comintern became a tool of Soviet foreign policy rather than a vehicle of Socialist internationalism.

<sup>119</sup> T.E. O'Connor, *The Engineer of Revolution. L.B. Krasin and the Bolsheviks 1870–1926*, p. 275

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Armenia, Georgia, Azerbaijan and the Far Eastern Republic on 5 November 1923 in Berlin, subsequently ratified in Berlin on 26 October 1923 and registered in League of Nations Treaty Series on 18 July 1924.<sup>120</sup>

In this complex international context, Bolsheviks, like the Peoples' Commissar for Foreign Trade Leonid Krasin, became more pragmatic.<sup>121</sup> A law passed on 21 August 1923 (that was later amended on 14 December 1927, and supplemented by ordinances on 23 May 1926 and 17 April 1928) formalized the principle by creating a Chief Concession Committee at the USSR *Sovnarkom*<sup>122</sup> (*Glavkontsessskom*) and a related legal mechanism (where usufruct was allowed without property right transfer in exchange of capital investment, recent technology transfer and royalties to compensate profits as well as the burden of exploitation). The foreign firm was in charge of organizing and financing the concession while the operation was under the responsibility of a Soviet entity.<sup>123</sup> Such system proved attractive as 1937 applications and 330 concession agreements (with a 17% success rate) were granted from 1921 to 1926.<sup>124</sup> Indeed, the German defeat at WWI in 1918 was considered by British traders as an opportunity to better penetrate the novel Russian market and by the British Prime Minister Lloyd George as a way to reduce import dependence on USA.<sup>125</sup> The latter also reactivated trade with Russia.<sup>126</sup> When considering the Caucasus oil fields that created the largest source of Russian finances with 20% of all exports by value before the Revolution and Civil War<sup>127</sup>, only massive material import and management supervision mainly from USA in 1921 countered the steep down production.<sup>128</sup>

Noteworthy, some Bolshevik leaders appeared to have gained private financial advantages from the NEP, as they managed to own, directly or through relatives, shares in local joint-stock companies.<sup>129</sup> However, considering the opportunities, such cases remained limited. Moreover, the levels of enrichment were not comparable to those of the following periods. As an example, Trotsky held 80,000 chervonets shares of Moskut (one of the most important stock companies, controlling factories in cloth, paper and glass industry). Zinoviev invested in Leningrad Tobacco Trust, ARCOS<sup>130</sup>, and owned 45% of Volkhostroi stock company. Dzerzhinsky was chairman and had 75,000 chervonets shares in the Coal Mines Exploitation Joint-Stock Company. Chicherin had interests in Turksholk (Turkish silk).<sup>131</sup>

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<sup>120</sup> Avalon Project, *Supplementary Agreement to the German-Russian Agreement (Treaty of Rapallo, April 16, 1922), November 5, 1922*

<sup>121</sup> R. Muntig, *op. cit.*, p. 258

<sup>122</sup> *Sovnarkom*, standing for *Soviet narodnykh kommissarov* or Council of People's Commissars, created shortly after the 1917 October Revolution became the highest executive authority. According to the 1918 RSFSR constitution, *Sovnarkom* could issue decrees carrying the force of law when the Congress of Soviets was not in session. The Congress then routinely approved these decrees at its next session. In December 1922, the USSR *Sovnarkom* replaced the RSFSR *Sovnarkom*.

<sup>123</sup> R. Muntig, *op. cit.*, p. 7

<sup>124</sup> *Ibid.*, p. 9

<sup>125</sup> C.A. White, *British and American Commercial Relations with Soviet Russia 1918-1924*, pp. 109

<sup>126</sup> J.M. Goldstein, *America's Opportunities for Trade and Investment in Russia*, pp. 1; J.E. Gay, *Anglo-Russian Economic Relations*, pp. 213

<sup>127</sup> A.C. Sutton, *op. cit.*, p. 16

<sup>128</sup> *Ibid.*, p. 17

<sup>129</sup> *Ibid.*, p. 308

<sup>130</sup> All-Russian Co-operative Society, Ltd. was a British company, and the official buying and selling agency of the Soviet government in UK. Information Department of the Russian Trade Delegation, "The Work of Arcos", 1921, p. 19. ARCOS should not be confused with the Arcos Banking Corporation, Ltd.; the latter being initiated by the Managing Board of ARCOS on 29 May 1923 and established with a capital of £ 250,000 on 5 July 1923. Russian Information Bureau, "Arcos Banking Corporation", pp. 351

<sup>131</sup> US State Dept. Enclosure to US Consulate in Riga, Report 2394, 24 September 1924 (Microcopy 316, Roll 129, Frames 1229); A.C. Sutton, *op. cit.*, p. 309

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In 1923, a tragic event at the periphery of the Conference of Lausanne<sup>132</sup> showed that even neutral Switzerland was shaken by the existence of USSR. On 10 May 1923, Maurice Conradi, a Russian White officer, with his accomplice Arkady Polunin shot dead Vatslav Vorovsky and additionally wounded two companions, Ivan Ariens and Maxim Divilkovsky, all members of the USSR delegation to the Lausanne conference. Conradi and Polunin managed to be acquitted. The trial, held in Lausanne, turned into the (popular) criticism of the Bolshevik Revolution and Red Terror, due to the support from Russian White émigrés on exile and media coverage. As a retaliatory measure, Soviet Union cancelled all Swiss concessions. This move turned to be a pure mark of diplomatic discontent as no Swiss concessions existed in Soviet Union at that time.<sup>133</sup>

The same year, USSR criticized the Ruhr occupation and supported Germany. However, in August 1923, the German government offered negotiations with France and Soviet Union considered this move as unfriendly. Therefore, the Soviet government via Zinovyev supported a German Communist putsch in Hamburg. When the attempt failed, USSR managed to resume its Rapallo diplomatic position even though the Russian trade headquarters in Germany were raided in search of political propaganda material.<sup>134</sup>

On 21 January 1924, Lenin died after successive serious health problems since mid 1921 (and the poorly treated wounds from his 1918 murder attempt). Lenin in his testament considered Trotsky and Stalin as his main potential successors. Trotsky was perceived as the "most capable man in the present Central Committee" even if he was too self-assured and supported excessive bureaucracy. Stalin was recommended to be removed from the position of General Secretary of the Communist Party that he got in 1922. However, Stalin had managed to control the access to Lenin and created the illusion to be his closest friend. He also rearranged Lenin's testament and gradually expanded his functions.<sup>135</sup>

In 1924, left wing (Labour) James Ramsay MacDonald and (Radical) Édouard Marie Herriot became respectively British Prime Minister and French President of the Council, i.e. Prime Minister.<sup>136</sup> Such governments promoted recognition of USSR, which occurred on 1 February for UK, 7 February for Italy and 28 October for France. Subsequently, MacDonald government tried to negotiate in August 1924 an Anglo-Soviet trade treaty (or a combination of agreements) in order to give British exports the most-favored-nation status. In return, USSR could have benefited from a loan if they settled the pre-revolutionary bond debts. However, hate of communism was fierce and the government fell through political intrigues (i.e. the Campbell Case and later the Zinovyev letter) without reaching a treaty approval. In the Campbell Case, MacDonald government ordered prosecution against John Ross Campbell, editor of the *Workers' Weekly* (a newspaper of the UK Communist Party), who had published a pro-pacifist pamphlet against the British army on 25 July 1924. However, on 13 August 1924, the MacDonald government pleased its Labour party by ordering the abrogation of the prosecution. Such decision directly led to a motion of no confidence and the dissolution of the

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<sup>132</sup> The goal of the 1922-3 Conference of Lausanne was to update the Treaty of Sèvres by defining the sovereignty of the new Republic of Turkey and the other former parts of the Ottoman Empire. Many issues regarding Arabia and traits connecting the Black Sea to the Mediterranean Sea where of great importance for UK and Soviet Union. L. Martin, "Treaty of Lausanne", *The Treaties of Peace 1919-1923*

<sup>133</sup> A.C. Sutton, *Western Technology and Soviet Economic Development 1930 to 1945*, p. 17

<sup>134</sup> W.A. McDougall, "A fragile stability, 1922-29" in *20th-century international relations – politics*

<sup>135</sup> M. Lewin, *Lenin's Last Struggle*, pp. 34 and 70; D.A. Volkogonov, *Lenin: Life and Legacy*, pp. 263, 273 and 416

<sup>136</sup> Note that these Prime Ministers jointly proposed to the League of Nations the Geneva Protocol for the Pacific Settlement of International Disputes. The protocol suggested a compulsory dispute arbitration at a World Court, a method to determine the aggressor in international conflicts and immediate assistance to the victims from League members. Even though the text was approved on 2 October 1924, the newly elected British Prime Minister Stanley Baldwin refused to ratify it, as British Conservatives feared that such protocol would lead to conflicts with USA. League of Nations, *Protocol for the Pacific Settlement of International Disputes*

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British parliament.<sup>137</sup> Then, on 25 October 1924, four days before the election, the Zinovyev letter was published by the Daily Mail. This document, considered a forgery by the British MI5 agency<sup>138</sup> and allegedly written by the President of the Communist International Grigory Yevseevich Zinoviev to the British representative on the Comintern Executive, ordered to support the potential 1924 Anglo-Soviet trade agreement as the first step of communist revolution in UK. MacDonald and the Labour party did not react fast enough and election was lost.<sup>139</sup> Now, it is considered that the Zinovyev letter episode had little impact on the electoral result but it clearly illustrates the political tension at that time.<sup>140</sup>

UK exports remained disadvantaged, as the novel government of Prime Minister Stanley Baldwin, 1<sup>st</sup> Earl Baldwin of Bewdley, denounced on 21 November 1924 the previously discussed Anglo-Soviet treaties and was furthermore reluctant in extending the export credit guarantee (ECG)<sup>141</sup> to Russia. Such position increased the risk bear by British companies but it was considered that German competitors were already too deeply implanted to be replaced. Russian extension of ECG appeared too demanding for the expected commercial outcome.<sup>142</sup> Indeed, most of the contracts or concessions were granted to German entities, such as the example of the gigantic 50,000-hectare Krupp agricultural concession in the North Caucasus in 1924 and the cotton irrigation contracts.<sup>143</sup>

However, USSR was informed that Germany planned to join the League of Nations (which became effective on 8 September 1926) and reacted by offering Germany to cooperate against Poland. But Germans considered the option as too hazardous.<sup>144</sup> On its side, Germany feared that USSR would ally with France, its greatest opponent, and thus concluded a German-Soviet commercial agreement on 12 October 1925.<sup>145</sup> However, to balance its international relations, Germany agreed in parallel to acknowledge post-war territorial settlement with WWI Allies and Central/Eastern European countries. The Locarno pact (combining seven agreements) was negotiated at Locarno from 5 to 16 October 1925 and formally signed in London on 1 December 1925. Later, USSR regained close contact with Germany; the Treaty of Rapallo was reaffirmed by the five-year Treaty of Berlin (German-Soviet Neutrality and Nonaggression Pact) on 24 April 1926, and renewed on 24 June 1931.<sup>146</sup> Such move was perceived as a direct threat to Poland and as potentially conflicting with the clauses of the Locarno Treaty.<sup>147</sup>

USSR appeared to be more successful in Far East. Recommendations from Lenin to support Asian expansion of Bolshevik revolution, mainly in China, were followed. However, the weakness of the latter was exploited to (i) grant protectorate over Outer Mongolia and to (ii)

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<sup>137</sup> D. Marquand, *Ramsay MacDonald*, p. 378

<sup>138</sup> C.M. Andrew, *Defend the Realm: The Authorized History of MI5*, p. 151

<sup>139</sup> D. Marquand, *op. cit.*, p. 382; C. Loch Mowat, *Britain Between the Wars 1918–1940*, pp. 188

<sup>140</sup> A.J.P. Taylor, *English History 1914–1945*, p. 219; W.A. McDougall, “A fragile stability, 1922–29” in *20th-century international relations – politics*

<sup>141</sup> ECGs are payment guarantees to protect exporters, and occasionally importers, from defaulting customers. As ECGs are granted by governmental or semi-governmental export credit agencies (ECAs) their use is controversial. Some developing countries consider that ECAs from wealthier countries artificially create competitive prices by better insuring exports. Proponents argue that thanks to ECGs developing countries benefit from import products they otherwise would not be able to afford. Noteworthy, the British ECA is named Export Credits Guarantee Department (ECGD) and managed by the British government. ECGD, as the world's first ECA, was established in 1919 to compensate the loss of UK exports during the submarine blockade of WWI.

<sup>142</sup> R. Muntig, *op. cit.*, p. 260

<sup>143</sup> A.C. Sutton, *Western Technology and Soviet Economic Development 1917 to 1930*, p. 114 and 121

<sup>144</sup> Z.J. Gasiorowski, “The Russian Overture to Germany of December 1924”, pp. 99

<sup>145</sup> R.P. Morgan, “The Political Significance of German-Soviet Trade Negotiations 1922–5”, pp. 253

<sup>146</sup> Avalon Project, *Treaty of Berlin Between the Soviet Union and Germany; April 24, 1926 (Complete)*; A.J. Crozier, *The causes of the Second World War*, p. 67; R.C. Tucker, *Stalin in power: the revolution from above 1928–1941*, pp. 227

<sup>147</sup> J.W. Garner, “The Russo-German Treaty”, pp. 530

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keep control of the Chinese Eastern Railway in Manchuria by the signature of a treaty in Beijing on 31 May 1924.<sup>148</sup>

In UK, social tensions persisted and climaxed at the 1926 General Strike. The General Council of the Trades Union Congress (TUC) initiated a strike on 4 May 1926 to prevent wage reduction and worsening conditions for 1.2 million locked-out coal miners. During 9 days 1.7 million workers, especially from transport and heavy industry, demonstrated in the whole country but the government had anticipated the perturbation and maintained a minimum service (via the use of a right-wing movement of volunteers affiliated to the government: the Organisation for the Maintenance of Supplies<sup>149</sup>). Furthermore, to weaken unions, the government blamed communists for stimulating subversive activities.<sup>150</sup> In 1927, USSR was the direct target of the British government. ARCOS offices in London, which also housed the official Soviet trade delegation, were raided by British authorities, as it was suspected to hide spying activities. Such violation of diplomatic immunity put an end to Anglo-Soviet diplomatic relations until 1930.<sup>151</sup> However, in 1928 trade relations resumed. The British Union Cold Storage concessions (exporting animal products to UK) were the first to be renewed.<sup>152</sup> Exports were vital for USSR to get foreign currencies and allow the industrialization policy.<sup>153</sup>

As USSR faced an increasingly united capitalist society, it intended to promote an "Eastern Locarno pact". But Poland and Rumania had become allies in 1926 and they offered an anti-Soviet alliance to Baltic states (eventhough some territorial and political tensions existed between Poland and Lithuania).<sup>154</sup> Thus USSR was surrounded: UK had ruptured; France was allied to hostile Poland and Rumania; anti-communist incidents occurred in Greece, Italy, Persia, Poland and Switzerland; relations with Germany, Persia and Turkey remained fragile; and finally the preparatory commission of the League of Nations<sup>155</sup> failed to

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<sup>148</sup> W.A. McDougall, "A fragile stability, 1922–29" in *20th-century international relations – politics*

<sup>149</sup> Anne Perkins, *A Very British Strike: 3 May - 12 May 1926*, p. 114; G.A. Phillips, *The General Strike: the politics of industrial conflict*, p. 134; P. Renshaw, *The General Strike*, pp. 131

<sup>150</sup> D.H. Robertson, "A Narrative of the General Strike of 1926", p. 376; W.A. McDougall, "A fragile stability, 1922–29" in *20th-century international relations – politics*

<sup>151</sup> W.A. McDougall, "A fragile stability, 1922–29" in *20th-century international relations – politics*; R. Muntig, *op. cit.*, p. 260

<sup>152</sup> A.C. Sutton, *Western Technology and Soviet Economic Development 1917 to 1930*, p. 125

<sup>153</sup> US State Dept. Report No. 3945, 25 September 1928

<sup>154</sup> P. S. Wandycz, *The Twilight of French Eastern Alliances, 1926-1936: French-Czechoslovak-Polish Relations from Locarno to the Remilitarization of the Rhineland*, pp. 36; M. Goldmanis, *Latvian Foreign Policy 1921-1940*; Note that through the Soviet-Lithuanian Non-Aggression Pact of 28 September 1926 (ratified on 9 November 1926 and confirming the Soviet-Lithuanian Peace Treaty of 1920) Soviet Union continued to recognize the Vilnius Region as Lithuanian while it was controlled by Poland since the Żeligowski's Mutiny in 1920. Furthermore, Soviet Union supported the sovereignty of Lithuania over the Klaipėda Region (Klaipėda Region for Lithuanians and Memel Territory for Germans) according to the Convention concerning the Territory of Memel of 8 May 1924. In return Lithuania agreed to refuse joining any alliances directed against the Soviet Union. Such *de facto* isolationism and risk of "Bolshevization" explained in part the 1926 Lithuanian coup d'état on 17 December 1926 and the following 14 years of authoritarian and nationalistic dictatorship. Poland (which experienced a coup d'état between 12 and 14 May 1926 in reaction to the 1925 Locarno Treaties, 1926 Treaty of Berlin and the related threat to Polish independence) claimed that the 1926 Soviet-Lithuanian Non-Aggression Pact violated the Treaty of Riga while Estonia and Latvia disapproved the Pact as it prevented the creation of a Baltic Entente. Such Entente was only allowed when the isolationism of USSR ended, i.e. when Soviet Union joined the League of Nations in 1934. Thus the Baltic Entente only took shape on 12 September 1934 with the signature of the Treaty of Good-Understanding and Co-operation in Geneva. A. Eidintas, V. Žalys and E. Tuskenis, *Lithuania in European Politics: The Years of the First Republic 1918-1940*, pp. 108

<sup>155</sup> The preparatory commission of the League of Nations was initiated in 1925 to prepare the (unsuccessful) 1932-34 Conference for the Reduction and Limitation of Armaments in Geneva.

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provide strong evidences that the League of Nations would protect disarmed countries from putative aggressive neighbours.<sup>156</sup>

Concerning internal policy, USSR gradually transformed itself into a dictatorship. In October 1926, Stalin managed to manipulate the Politburo (Political Bureau of the Central Committee of the Communist Party of the Soviet Union)<sup>157</sup> in order to eject the most influential members and his direct competitors, notably Trotsky. In December 1927, Stalinism was the new political line to be followed in a mandatory manner. Other options were eradicated, as exemplified by the obliged exile of Trotsky in January 1929 and his assassination in 1940 in Mexico. Foreign communist parties were obliged to follow the line too. Social democracy was considered as a weak leftist political position, and confrontation against capitalism was favored.<sup>158</sup>

In 1928, the show trials started to be used as a tool of international policy. Five German engineers from Allgemeine Elektrizitäts Gesellschaft (AEG), who worked at the Shakhtinsky coalmines in the Don region, were officially charged of counter-revolutionary plot against the coal industry.<sup>159</sup> To create the illusion of a real case and to keep commercial relationship, AEG was not accused.<sup>160</sup> AEG indeed decided to resume work.<sup>161</sup> The goal of the show trial was to get a mean of influencing the terms of a German-Soviet treaty that was to be negotiated. Moreover, OGPU considered German dominant position in investment as a danger. As a second threat, Soviet industry was not controlled by the communist party but mainly managed by German as well as pre-revolutionary engineers. The show trial was used to decrease the German overconfidence: Germany was the first commercial partner but such situation should not be taken as granted and could change in the close future. In 1928-9, American technical support was preferred. The show trial was further used to warn the other foreign governments and the Ukrainian nationalists. Finally, the German workers were scapegoats for the general poor efficiency in coal extraction.<sup>162</sup>

Globally, NEP was successful in supporting the recovery from the destructions of WWI, the 1917 Revolution and the Civil War.<sup>163</sup> However, it could be only a temporary measure as it was shaking the revolutionary principles. In 1928, the Grain Procurement Crisis illustrated the limitations of administrated economy and the poor understanding of economic mechanism within the government.<sup>164</sup> NEP allowed a private market in parallel to the state controlled grain purchase. From mid 1926 to mid 1928, global grain production officially slightly decreased (respectively from 74.6 million tons to 72.5 million tons) and State wheat prices followed the same trend according to administrative decisions (respectively from 648 to 611 kopeks<sup>165</sup> per

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<sup>156</sup> P. S. Wandycz, *The Twilight of French Eastern Alliances, 1926-1936: French-Czechoslovak-Polish Relations from Locarno to the Remilitarization of the Rhineland*, pp. 36; J.P. Kinross, *Atatürk: a biography of Mustafa Kemal father of modern Turkey*, p. 464; E. Forestier-Peyrat, "Red Passage to Iran: The Baku Trade Fair and the Unmaking of the Azerbaijani Borderland 1922-1930", pp. 79; Mehdiyoun, Kamyar. "Ownership of Oil and Gas Resources in the Caspian Sea", pp. 180

<sup>157</sup> Editors of Encyclopædia Britannica, *Politburo*. Politburo is the English translation of Russian *Politbyuro*, which is a contraction of *Politicheskoye Byuro*, "Political Bureau". Officially, according to democratic centralism, the Party Congress elected a Central Committee which, in turn, elected the Politburo and General Secretary.

<sup>158</sup> W.A. McDougall, "A fragile stability, 1922-29" in 20th-century international relations – politics

<sup>159</sup> Izvestia, No. 60, 10 March 1928

<sup>160</sup> Izvestia, No. 61, 11 March 1928; A.C. Sutton, *Western Technology and Soviet Economic Development 1917 to 1930*, p. 325

<sup>161</sup> A.C. Sutton, *Western Technology and Soviet Economic Development 1917 to 1930*, p. 294

<sup>162</sup> US State Dept. Decimal File, National Archives Microcopy 361, Roll 6221, Frames 13 and 32, Report 1671, 10 April 1928

<sup>163</sup> J.F. Karcz, "Thoughts on the Grain Problem", pp. 410

<sup>164</sup> P.R. Gregory, *Reforming the Soviet Economic Bureacracy*, pp. 156; J.F. Karcz, *op. cit.*, pp. 432

<sup>165</sup> The ruble was subdivided into 100 kopeks.

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centner<sup>166</sup> according to official statistics). Following the balance of supplies and demands, prices on the private market increased in parallel (respectively from 861 to 1120 kopeks per centner). State offered to buy peasants' products at low prices (sometimes not covering production costs) while private market was legally free to define its prices. Within this competition, state was not providing sufficient incentive. Consequently, peasants preferred to sell their harvests on the private market, which diverted a part of the agricultural production from administrative control and statistics (the global decline in grain production is now debated).<sup>167</sup> Government took measures including force and requisition to collect grain (as early as October 1927) and to reduce freedom of private sector.<sup>168</sup> Such crisis had major political consequences. Peasants who were taking advantage of the private market (mainly *kulaks* and to a lower extent *seredniaks*<sup>169</sup>) improved their conditions. Such economic better off could lead to political power and criticism of communism in a country where 80% of the population was rural.<sup>170</sup> Thus discrimination under charges of Soviet regime sabotage started. However, the action appeared arbitrary, unjust and self-defeating as the categories of *kulaks*, *seredniaks*, and *bedniaks* were legally unclear.<sup>171</sup> The grain crisis caught Stalin and other Party leaders by surprise but the leader used this fear to impose his own policy (especially by reediting the requisitions of the 1925 limited procurement crisis<sup>172</sup>) and justify forced collectivization of agriculture in 1929.<sup>173</sup> To Stalin's view, industrial sector was the priority in order to strengthen the country against the capitalist encirclement and competition. Investments in the industrial sector were at the expense of agriculture and NEP.<sup>174</sup> However, the Grain Procurement Crisis forced Soviet state to import grain for the first time in Russian economic history.<sup>175</sup> As USSR lost resources from grain exports and required funds for mandatory food imports, alternatives had to be quickly found in order to get foreign currencies. Thus diary exports together with lumber mainly replaced lost grain exports.<sup>176</sup>

## 6. Great Turn and the First Five-Year Plan (1928-1932)

The years 1928-9 saw a drastic change in the Soviet economic policy that was called the Great Turn or Great Break.<sup>177</sup> A Five-Year Plan, including mass collectivization in the countryside and industrialization in cities, replaced the NEP.

Launch of this first Five-Year Plan was not sharp, only subsequent propaganda claimed so and defined it as 1928.<sup>178</sup> Initial mass collectivization was supposed to be gradual,

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<sup>166</sup> Centner or quintal is defined in USA as short or central hundredweight and corresponds to 100 lb, i.e. 45.359237 kg. Note that in the imperial system centner or quintal exists as the long or imperial hundredweight (112 lb or 50.802345 kg).

<sup>167</sup> P.R. Gregory and M. Mokhtari, "State Grain Purchase, Relative Prices, and the Soviet Grain Procurement Crisis", pp. 182; J.F. Karcz, "Thoughts on the Grain Problem", pp. 399; S. Merl, *Der Agrarmarkt und die Neue Oekonomische Politik*, pp. 39

<sup>168</sup> S. Merl, *op. cit.*, pp. 313

<sup>169</sup> *Kulaks*, the higher-income farmers, *seredniaks*, the mid-income peasants, and *bedniaks*, poor peasants, were considered by Soviets as the main peasant classes. Sometimes, was also added the *batraks*, landless seasonal agriculture workers for hire; R. Conquest, *The Harvest of Sorrow: Soviet Collectivization and the Terror-Famine*, pp. 1

<sup>170</sup> J.R. Millar and C.A. Guntzel, "The Economics and Politics of Mass Collectivization Reconsidered: A Review Article", pp. 105 and 108

<sup>171</sup> M. Lewin, *Russian Peasants and Soviet Power: A Study of Collectivization*, p. 49

<sup>172</sup> M. Lewin, *op. cit.*, p. 517

<sup>173</sup> M. Lewin, *op. cit.*, pp. 214

<sup>174</sup> J.R. Millar and C.A. Guntzel, *op. cit.*, pp. 108

<sup>175</sup> M. Lewin, *op. cit.*, pp. 214

<sup>176</sup> US State Dept. Report No. 3945, 25 September 1928

<sup>177</sup> The "Great Turn" term originates from the title of Stalin's article "Year of the Great Turn", which was published on 7 November 1929 at the 12<sup>th</sup> anniversary of the October Revolution; L. Viola, *Peasant Rebels Under Stalin: collectivization and the culture of peasant resistance*, pp. 1



voluntary and non-exploitative in order to build strong socialist bonds with the peasantry.<sup>179</sup> However, the occurrence of the Grain Procurement Crisis obliged a swift change in the political agenda and Stalin ordered a harsher process without knowing all the entailed consequences.<sup>180</sup> Such fast agricultural mass collectivization was at the expense of millions of lives.<sup>181</sup> Unpreparedness led to successive famines that created deep hatred of Russians by other ethnic groups, such as Ukrainians and Tatars.<sup>182</sup> Moreover, the global policy did not take into account local needs and specific cultures. For example, nomadic Turkmen were obliged to shift their production from food crops to cotton.<sup>183</sup> Expropriation of Kulaks was so aggressive that many preferred to slaughter their livestock (and keep meat) than to give it up to *kolkhoz*, the collective farms. *Kolkhoz* (on average made of 75 families) were gradually mechanized but state tractors had to be rented. Such method allowed the government to maintain a stricter control on the peasantry. As USSR was desperately in search for income to finance its industrialization, crop was sold on the world market at dumping prices. It contributed to the global overproduction and the worsening of the Great Depression in the rest of the world.<sup>184</sup> As USSR, the sole communist state in the world, had limited international trade exchanges, it remained quite unimpacted by the Great Depression. At that time, some Western intellectuals credited such protection to superiority of communism over capitalism.<sup>185</sup> This situation attracted a mass immigration mostly from Finland and Germany but the illusion of reaching an *El Dorado* quickly disappeared.<sup>186</sup>

The main focus of the first Five-Year Plan was heavy industrialization (and related military preparedness), as Stalin was convinced that a war from the West would inevitably occur in the coming years. Urgent and major measures in automotive, aviation, gas, oil, steel and tire industries were taken such as the import of entire factories from France, Germany, Italy and USA.<sup>187</sup> Between 1928 and 1929, devoted workforce doubled from 3.12 millions to 6.01 millions respectively. To accelerate the process, most of Soviet resources were rerouted to the heavy industry and unconnected projects cancelled. Even food, which was scarce in USSR, was preferably provided to workers from factories in this field.<sup>188</sup>

As pressure to catch up Western levels of industrial production was high, it was initially thought to free prisoners. However it was quickly realized that compulsory work of prisoners would be more advantageous. To increase this free labor force, legislation was adapted and conviction judgements encouraged. Abroad, like in USA, boycotts were organized to denounce such actions. Note that internal resistance to mass collectivization in the countryside became a

<sup>178</sup> A.C. Sutton, *Western Technology and Soviet Economic Development 1917 to 1930*, p. 346

<sup>179</sup> M. Lewin, *op. cit.*, p. 357

<sup>180</sup> M. Lewin, *op. cit.*, p. 264; J.R. Millar and C.A. Guntzel, *op. cit.*, pp. 114

<sup>181</sup> S. Fitzpatrick, *The Russian Revolution*, 1994, p. 139

<sup>182</sup> During the Russian campaign of WWII, Nazis took advantage of this feeling.

<sup>183</sup> A. Edgar, *Tribal Nation*, p. 296

<sup>184</sup> W.A. McDougall, "The origins of World War II, 1929–39" in *20th-century international relations – politics*; W.W. Cochrane, *Farm Prices, Myth and Reality*, p. 15; J.A. Garraty, *The Great Depression: an inquiry into the causes, course, and consequences of the worldwide depression of the nineteen-thirties, as seen by contemporaries and in the light of history*, pp. 1

<sup>185</sup> "As the Great Depression ground on and unemployment soared, intellectuals began unfavorably comparing their faltering capitalist economy to Russian Communism. [...] More than ten years after the Revolution, Communism was finally reaching full flower, according to New York Times reporter Walter Duranty, a Stalin fan who vigorously debunked accounts of the Ukraine famine, a man-made disaster that would leave millions dead."; J. Burns, *Goddess of the Market: Ayn Rand and the American Right*, p. 34

<sup>186</sup> R.W. Davies, M. Harrison and S.G. Wheatcroft, *The economic transformation of the Soviet Union 1913-1945*, pp. 1; W.A. McDougall, "A fragile stability, 1922–29" in *20th-century international relations – politics*

<sup>187</sup> W.A. McDougall, "A fragile stability, 1922–29" in *20th-century international relations – politics*

<sup>188</sup> S.E. Hanson, *Time and Revolution: Marxism and the Design of Soviet Institutions*, p. 95; N.S. Khrushchev, *Memoirs of Nikita Khrushchev, Commissar 1918-194*, p. 56

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provider of free workers in labour camps. And, at the same time, imprisonment of protesters quickly eradicated criticism of the governmental policy.<sup>189</sup> Moreover, from 1929, general complaints against the first Five-Year Plan were evacuated through the use of purge campaigns of the "Right Opposition".<sup>190</sup> In parallel, the cult of personality, which gradually focused on Stalin only, appeared as a reaction to the narrowing of the supporting basis of the rulers. The power was concentrated to smaller circles within the communist party, the privileged and loyal *apparatchiki*. The revolutionary movement became a conservative administrative structure.<sup>191</sup>

When considering globally the first Five-Year Plan, it appears that industrial production supported the Soviet economy at sustained and relatively rapid growth rate. However, agricultural production stagnated in quantity and reduced in quality.<sup>192</sup>

At the international level, USSR formally adhered to the General Treaty for Renunciation of War as an Instrument of National Policy (informally called the Kellogg-Briand Pact or Pact of Paris) on 24 July 1929 (the first countries signed on 27 August 1928). This agreement, concluded outside the League of Nations, was supposed to outlaw war: *The High Contracting Parties agree that the settlement or solution of all disputes or conflicts of whatever nature or of whatever origin they may be, which may arise among them, shall never be sought except by pacific means.*<sup>193</sup> Such pacifist trend continued with the General Act for the Pacific Settlement of International Disputes (under the aegis of the League of Nations), which was signed on 26 September 1928 in Geneva by 22 states (excluding USSR as the latter only joined the League of Nations in 1934).<sup>194</sup> Unfortunately, as an unexpected consequence, the subsequent wars were initiated without official declaration.<sup>195</sup>

To stabilize relations with its close Western neighbours, USSR extended the Kellogg-Briand Pact with the Litvinov Protocol (officially entitled Protocol for the Immediate Entry into Force of the Treaty of Paris of August 27, 1928, Regarding Renunciation of War as an Instrument of National Policy).<sup>196</sup>

Regarding the other countries, the Great Depression had obliged Western powers to focus on their internal issues. As an example, 22% of the British adult male work force was unemployed. On 21 September 1931, as the Bank of England stopped using the gold standard, the pound sterling (a reference currency) promptly dropped by 28%, which reduced the solvency of many countries in the world. In October 1931, emergency measures were taken by an ad hoc British coalition government (Baldwin been the *de facto* Prime Minister in place of the official Prime Minister MacDonald). And the 1932 Imperial Economic Conference at Ottawa initiated the British Commonwealth of Nations in order to create protective customs tariffs and "Imperial preference". It was the end of 86 years of British free trade policy.<sup>197</sup>

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<sup>189</sup> J. Scherer, "The collectivisation of agriculture and the Soviet prison camp system", pp. 535

<sup>190</sup> W.A. McDougall, "A fragile stability, 1922–29" in 20th-century international relations – politics

<sup>191</sup> J.R. Millar and C.A. Guntzel, *op. cit.*, pp. 103

<sup>192</sup> J.R. Millar and C.A. Guntzel, *op. cit.*, pp. 103

<sup>193</sup> Avalon Project, *Kellogg-Briand Pact 1928*. Note that later the treaty served as the legal basis for the notion of crime against peace.

<sup>194</sup> Such act offered three alternatives but mandatory dispute resolution systems: a conciliation commission (articles 1 to 16), an arbitration tribunal (articles 21 to 28) and the ultimate option, the Permanent Court of International Justice (articles 17 to 20). League of Nations, *Pacific Settlement of International Disputes, General Act, Geneva, September 26, 1928*, League of Nations Treaty Series, vol. 93, No. 2123, pp. 345

<sup>195</sup> e.g. 1931 Japanese invasion of Manchuria, 1935 Italian invasion of Abyssinia, 1939 Soviet invasion of Finland, 1939 German and Soviet Union co-invasion of Poland. C. Quigley, *Tragedy and hope: A history of the world in our time*, pp. 294

<sup>196</sup> The initial signatories, Estonia, Latvia, Poland, Romania and USSR, were later joined by Finland, Lithuania, Persia and Turkey. X.J. Eudin and R.M. Slusser, *Soviet Foreign Policy 1928-1934*, p. 7; League of Nations, *Protocol for the immediate entry into force of the Treaty of Paris of August 27, 1928, regarding renunciation of War as an Instrument of National Policy*, pp. 370

<sup>197</sup> W.A. McDougall, "The origins of World War II, 1929–39" in 20th-century international relations – politics; Editors of Encyclopædia Britannica, *Imperial Economic Conference*

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Thus, Western countries gradually considered USSR existence as an *état de fait*, but ideological opposition remained fierce. On the other side, USSR adjusted at its own advantage the international commercial relationships. By the early 1930s, abandonment of international concessions was forced and replaced by technical-assistance agreements, which were considered as better optimizing technology transfer.<sup>198</sup>

## **B. Lena Goldfields Ltd prior 1925 and relevance of foreign concessions**

The present section will focus on the history of the Lena Goldfields Ltd prior to 1925 and the relevance of foreign concessions in Russia from 1920 to 1930.

While the Lena Goldfields arbitration case was related to the concession awarded in 1925, the London-registered company existed since 1908.<sup>199</sup> During the Russian empire era, in 1912, the company was involved in a tragic event called the Lena Massacre that deeply moved the whole Russian population.<sup>200</sup> This event immediately contributed to a pre-revolutionary climate that favored the 1917 Revolution. Obviously, the 1912 Lena Massacre and the related poor reputation of Lena Goldfields Ltd was in the mind of the Soviet government and population when the Lena Goldfields arbitration occurred. Soviet propaganda had in hand a sledgehammer argument and could amplify the aversion to the company by mentioning the widespread anti-communist convictions in UK, the country of origin of the enterprise.

To follow the historical evolution of the interest of Soviet government in foreign concessions, especially in the Lena region, the present section will be divided in four parts: Lena Goldfields Ltd and the Lena Massacre in 1912; Relevance of foreign concessions in the Lena river region in the 1920s and -30s; Attractivity of foreign concessions in the 1920s; Expropriation conditions of foreign concessions in the 1920s and -30s.

### **1. Lena Goldfields Ltd and the Lena Massacre**

The Russo-Japanese War (8 February 1904 - 5 September 1905) and the 1905 Revolution deeply shook the Russian empire and impacted on the value of its currency. As the currency was on the gold standard, gold production became of national strategic importance.

The Lena river region<sup>201</sup> has always been known as one of the richest goldfield area in the world. In 1913, 121 mines were producing gold and employed 10,000 workers.<sup>202</sup> At the time of the massacre, in 1912, *Lenzoloto*, the Russian subsidiary of Lena Goldfields Ltd, had managed to control most of gold extraction in the region (and owned the other richest sites in the Russian empire). Concretely speaking, such situation did not appear completely incompatible with the preservation of Russian national interests, as high-rank members of the

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<sup>198</sup> "A combination of American business and science with Bolshevik wisdom has created these giants in three or four years..." *Za Industrializatsiiu*, 14 August 1933; A.C. Sutton, *Western Technology and Soviet Economic Development 1930 to 1945*, p. 2;

<sup>199</sup> Annex 2 - Copy of a Lena Goldfields Ltd share warrant given on 4 May 1910. Lena Goldfields Ltd controlled 66% of the shares of the Russian company *Lenskoe zolotopromyshlennoe tovarchestvo* (Lena Gold Mining Joint Stock Company; "*Lenzoloto*"), which was incorporated in 1855 to extract gold along the river Lena and its tributaries in Siberia.

<sup>200</sup> As an anecdote, the Lena massacre quickly eclipsed in the Soviet newspapers the concomitant sinking of the RMS Titanic and the death of more than 1,500 people on 14 April 1912. M. Melancon, "Unexpected consensus: Russian society and the Lena Massacre, April 1912, pp. 1

<sup>201</sup> Goldfields of the Lena river region are roughly 400 km and 800 km northeast from the Lake Baikal and the Trans-Siberian railway respectively; more precisely, 45 km northeast of the town of Bodaybo in Irkutsk Oblast, on the upper branches of the Vitim river, i.e. 1,000 km before the Vitim river flows into the Lena river (cf. Annex 4 - Location of the activities of Lena Goldfields Company Ltd). Note that the local climate was subarctic with extreme variation of temperatures between seasons (from -34°C to +26°C) and roughly 220 days of precipitation per year.

<sup>202</sup> A.C. Sutton, *Western Technology and Soviet Economic Development 1917 to 1930*, pp. 92

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government, such as Aleksei Putilov<sup>203</sup>, were included in the board of directors. Moreover, only 30% of Lena Goldfields Ltd shares, i.e. 20% of *Lenzoloto* shares, were owned by British investors while 70% of Lena Goldfields Ltd shares, i.e. 46% of *Lenzoloto* shares, were controlled by Russians, e.g. Empress Maria Feodorovna<sup>204</sup> and Count Sergei Yulyevich Witte<sup>205</sup>. Noteworthy, a Committee of the Russian investors within the Lena Goldfields Ltd strengthened the Russian cohesion.<sup>206</sup>

Such monopoly did not stimulate improvement in working conditions. Even if gold extraction provided employment, workers had to be active around 15 to 16 hours per day. Protective measures in mines were very limited which led to accident rate around 700 per thousand employees. Moreover, as most local stores were controlled by the employer and food supply was difficult in this remote area, workers were captive customers. Salary was partly paid in coupons to be used in the employer's shops and some arbitrary fines reduced the remaining.<sup>207</sup>

In February 1912, social tensions increased about poor working conditions. On 13 April [O.S. 31 March] 1912, the distribution of rotten meat at one of the Lenzoloto's stores of the Andreyevsky goldfield was the triggering event of a spontaneous strike. Four days later, specific requests made: food quality should improve, the maximum workday should not exceed 8 hours, wages should increase by 30% and fines should cease to be used. In response to the flat refusal of the company, the strike spread to all the local goldfields, including more than 6,000 workers, and a Central Strike Committee with a Central Bureau were created thanks to the presence of political exiles with past socialist and strike experience. Such structure led to a careful planning of the demonstrations to avoid breaching the legal rules of the strike. On its side, the employer repeatedly violated work contract and existing labor laws. This attitude stimulated in reaction a hard-line five-week-long strike. At that point, the government, which supported the employer, sent a company of soldiers to strengthen the local limited contingent and arrest the leaders. On 17 April [O.S. 4 April] 1912, the day following the arrival of the troops, thousands of unarmed strikers converged to Lenzoto's local headquarter to petition for the release of their leaders. Such action stressed the police and army forces, which led to the opening of fire on the crowd. Hundreds were wounded and some killed.<sup>208</sup>

Within a few days, the press became aware of this tragedy, which broke out into a heavy criticism of the apparent collusion between the government and the private entity Lenzoloto. The story of the 'Lena tragedy' or 'Lena drama' had national coverage and triggered spontaneous protests and demonstrations in the whole country while political opposition, e.g. socialists, were caught by surprise. Such movement could not be stopped by censorship as the Third State Duma deliberated on the topic from 9 to 25 April. Media were relaying the public Duma sessions' minutes. When Nikolai Makarov, Minister of the Interior, stated about the tragedy: "So it has always been and so it will always be."<sup>209</sup>, public opinion considered the tsarist regime as perpetrator of the Lena Massacre. Even political groups normally supportive

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<sup>203</sup> Aleksei Putilov was an assistant to the Russian Minister of Finance from October 1905 to April 1906 and then joined the private sector. He managed financial and industrial enterprises, notably the Russo-Asiatic Bank (with Russian and French capital) in Saint Petersburg, until the Bolshevik Revolution.

<sup>204</sup> Maria Feodorovna was a Danish princess, Empress of Russia as spouse of Tsar Alexander III, and mother of Tsar Nicholas II.

<sup>205</sup> Count Sergei Yulyevich Witte served under the last two Russian emperors, Alexander III and Nicholas II. He proved to be influential and reformist as Minister of Finance, diplomat and first Chairman of the Russian Council of Ministers (Prime Minister). In 1907, he was disgraced but remained member of the State Council.

<sup>206</sup> F.A. Kudryavtsev, *Harbinger of revolutionary storm*, pp. 70-112; M. Melancon, "The Ninth Circle: The Lena Goldfield Workers and the Massacre of 4 April 1912", pp. 766

<sup>207</sup> M. Melancon, "The Ninth Circle: The Lena Goldfield Workers and the Massacre of 4 April 1912", pp. 766

<sup>208</sup> Annex 3 - Pictures related to the 1912 Lena Massacre; M. Melancon, "Unexpected consensus: Russian society and the Lena Massacre, April 1912", pp. 1

<sup>209</sup> S.S. Montefiore, *Young Stalin*, Weidenfeld & Nicolson, London, p. 210

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of the government contributed to the blame of the shooting and the related social situation.<sup>210</sup> However, in the end, no official accusatory motion was adopted and the topic was considered 'exhausted' by the Duma chairman.<sup>211</sup> The only legal impact of the tragedy was the acceleration of the passing of a worker insurance law that had fortuitously reached the Duma several months before. Furthermore, on related aspects, a law opening institutions of higher education to women was validated and a law for free state-sponsored, compulsory universal education for children was evaluated.<sup>212</sup>

Noteworthy, at public demand the government sent a commission, headed by Alexander Kerensky, to investigate the incident. The commission chairman, who was at that time a parliamentary backbencher of the socialist opposition to the government, gained public recognition through his report and promoted the awareness of the working conditions in mines. Later, he contributed to unite the anti-monarchy forces and became a prominent figure of the 1917 Provisional Government.<sup>213</sup>

Societal impact of the Lena massacre should be remembered when analysing the subsequent events related to the Lena Goldfields Ltd. The tragedy was since its occurrence considered as a Russian symbol of class warfare. Lenin stated that the massacre had "*inflamed the masses with a revolutionary fire*".<sup>214</sup> And Joseph Stalin declared: "*The Lena shots broke the ice of silence, and the river of popular resentment is flowing again. The ice has broken. It has started!*".<sup>215</sup>

Such poor working conditions of miners were actually evenly distributed around the globe. In 1912, the era of industrialization had reached its maturity in many countries and social unrest was intense, as workers did not enjoy many social protections at that time. In UK, the 1912 national coal strike of 37 days (28 February - 6 April) with nearly one million protesters led to the 1912 Coal Mines Act and the securing of a minimum wage for the coal miners.<sup>216</sup> In Germany, 200,000 demonstrators from the Westphalia coalmines went on strike on 11 March 1912.<sup>217</sup> On 30 March 1912, work day of French coal miners was limited by a decision of the Chamber of Deputies.<sup>218</sup> On 12 November 1912, the greatest strike in New Zealand's history took place at the Waihi gold mines. In USA, Paint Creek Mine War started on 18 April 1912 and lasted more than one year.<sup>219</sup> It was the starting event of the worst conflicts in American labor union history in the subsequent years, the West Virginia battles of Matewan and Blair Mountain.<sup>220</sup>

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<sup>210</sup> M. Melancon, "Unexpected consensus: Russian society and the Lena Massacre, April 1912", pp. 31 and 45; R. Zelnik, "Revolutionary Russia 1890-1914", p. 263; *Novoe vremia* newspaper, 8-27 April 1912; *Russkie vedomosti* newspaper, 8-26 April 1912; *Lenskie sobytiia* newspaper, vol. 2, pp. 255-350; Duma debates about the Lena shooting, *Gosudarstvennaia Duma* (verbatim report), *Stenograficheskii otchet* (third convening), *Sessia piataia* (Session Five), St Petersburg, 1912: 9 April session, pp. 1659-89; 10 April session, pp. 1794-1829; 11 April session, pp. 1945-63; 18 April session, pp. 2736-52; 25 April session, pp. 3325-52.

<sup>211</sup> M. Melancon, "Unexpected consensus: Russian society and the Lena Massacre, April 1912", pp. 44

<sup>212</sup> *Ibid.*, pp. 48

<sup>213</sup> M.S. Melancon, The Lena Goldfields Massacre and the Crisis of the Late Tsarist State, pp. 167; V.D. Medlin, "Alexander Fedorovich Kerensky", p. 128

<sup>214</sup> M.S. Melancon, The Lena Goldfields Massacre and the Crisis of the Late Tsarist State, pp. 167

<sup>215</sup> S.S. Montefiore, *Young Stalin*, p. 210

<sup>216</sup> B.R. Mitchell, *Economic Development of the British Coal Industry 1800-1914*, pp. 190; New York Times, *1,000,000 British Miners Strike*, 2 March 1912

<sup>217</sup> New York Times, *15,000 German Miners Back*, 17 March 1912

<sup>218</sup> Albert Shaw, "Record of Current Events", p. 540

<sup>219</sup> E.M. Steel, *The court-martial of Mother Jones*, p. 61

<sup>220</sup> R. Shogan, The Battle of Blair Mountain: The Story of America's Largest Labor Uprising, p. 38; H.B. Lee, Bloodletting in Appalachia: The Story of West Virginia's Four Major Mine Wars and Other

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## 2. Relevance of foreign concessions in the Lena river region

Prior to the 1917 Revolution, 39 foreign and Russian companies operated in the Lena river area.<sup>221</sup> Equipment was of excellent quality with connection to hydroelectric power plant.<sup>222</sup> The gold and platinum concessions from tsarist government to British companies in the region were self-sufficient with fields for agriculture, small-consumer goods manufactures, smelters, iron and steel plants.<sup>223</sup> The Revolution and the following Civil War triggered the departure of Western owners, including the Lena Goldfields Ltd, and many skilled employees. This combined to the elimination of financial incentives to workers contributed to a catastrophic decrease in Russian production: 1921 levels represented 1% of those of 1913.<sup>224</sup> The Siberian Revolutionary Council preferred to suspend operations as profits did not cover the costs of the 9,000 workers.<sup>225</sup> However, The Soviet of Labor and Defense overruled this order as gold extraction was of national importance. Thus, a decree authorizing special concessions for gold and platinum production replaced the 1920 decree forbidding private interests in gold mining. Prospectors were welcome and in December 1921 a Lenzoloto trust was offered with exclusive access to the main mines on the right bank of the Lena river.<sup>226</sup> In 1922, the situation worsened and it was envisaged to fully transfer the Lena fields to the private sector. In 1923, authorities were desperate and considered closure of all activities as cost-revenue ratio reached 25:1.<sup>227</sup> On that year, finances and management remained inappropriate and employment dropped to 5,000 workers. In the middle of the year, a French mining expert, Professor Barbot-de-Marni, was mandated to evaluate the situation and make recommendations. According to him, most of extraction material had to be renewed and skilled operators hired. Moreover, in the rare cases where material was modern, no exploration or work was in progress. Thus state assistance was mandatory.<sup>228</sup> However, at that period, Soviet public finances were so low that the modern 5.6 meter-high Bucyrus dredge bought in USA in 1916 to accelerate gold extraction in the Lena river area could not be brought to the final destination. It remained in San Francisco unused.<sup>229</sup> A drastic alternative was adopted: thirty-four leasing contracts with private individuals and entities were signed just for the Lena river region.<sup>230</sup> In 1925, gold extraction was reactivated and later became a major asset to cover foreign imports.<sup>231</sup>

Before NEP, Soviet Russia heavily relied on foreign imports (mainly railway equipment). The only source to finance them was gold, which led to exhaustion of half the reserves by 1922. Thus gold extraction was a vital national need to try to compensate the loss.<sup>232</sup>

To complexify the situation, the Soviet regime was not recognized by the other nations until 1924. Moreover, many foreign countries, banks or companies had pending receivables and lost assets located in Russia due to the 1917 Revolution and the Civil War. Thus, Russian exported gold could be seized as security against this public debt or could be considered as stolen property from foreign companies. Indeed, a 'gold blockade' was created around Soviet

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Thrilling Incidents of Its Coal Fields, p. 22; H.N. Wheeler, "Mountaineer Mine Wars: An Analysis of the West Virginia Mine Wars of 1912-1913 and 1920-1921", pp. 69

<sup>221</sup> A.C. Sutton, *Western Technology and Soviet Economic Development 1917 to 1930*, p. 92

<sup>222</sup> *Ekonomicheskaya Zhizn*, No. 196, 2 September 1922

<sup>223</sup> A.C. Sutton, *Western Technology and Soviet Economic Development 1917 to 1930*, p. 92

<sup>224</sup> *Ekonomicheskaya Zhizn*, No. 172, 4 August 1922; *Isvestia*, No. 213, 22 September 1922

<sup>225</sup> A.C. Sutton, *Western Technology and Soviet Economic Development 1917 to 1930*, pp. 92

<sup>226</sup> *Ekonomicheskaya Zhizn*, No. 196, 2 September 1922

<sup>227</sup> *Ekonomicheskaya Zhizn*, 20 February 1923

<sup>228</sup> A.C. Sutton, *Western Technology and Soviet Economic Development 1917 to 1930*, pp. 92

<sup>229</sup> A.C. Sutton, *Western Technology and Soviet Economic Development 1917 to 1930*, p. 93

<sup>230</sup> *Ekonomicheskaya Zhizn*, No. 143, 29 June 1923

<sup>231</sup> D.B. Shimkin, *Minerals: A Key to Soviet Power*, p. 172

<sup>232</sup> R. Muntig, *op. cit.*, p. 258

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Russia in addition to the trade blockade. Fortunately for the Soviets, Sweden did not implement the gold blockade and consequently it became the main platform of Soviet gold transfer. Regarding the British government, it assured that it would not lay claim related to payment in gold but no control over potential actions from private entities or individuals could be guaranteed. In the end, no such action occurred and in 1924 the official recognition of USSR precluded this possibility.<sup>233</sup>

### 3. Attractivity of Foreign Concessions

As previously explained, the use of long-term loans to rebuild the economy would have been the first option if the political tension between Soviet Russia and the countries controlling the banks did not exist. Moreover, such concept was in opposition to the principles of the Revolution and independence from capitalism.<sup>234</sup>

The simplest alternative at the launch of NEP appeared to be the creation of concessions (including pure and mixed companies). The initial Soviet plans included only former foreign-owned factories and equipment but the offer gradually expanded. Globally, several hundred concessions were signed. The manufacturing sector was mainly awarded to German, American or Swedish companies while British enterprises were prominent in forestry and mining.<sup>235</sup>

To reach its objective of independence and acquisition of knowledge from abroad, USSR realized that technical assistance contracts were more appropriate than concessions. It notably avoided the transfer of ownership. Thus harsh methods were used to quickly replace concessions by these technical assistance contracts. Only 59 concessions remained in October 1929, including six British, 12 German, and 11 Japanese. Furthermore, technical assistance contracts were combined to the order of complete plants from abroad in order to fully optimize the acceleration of Soviet industrialization. In the end, USSR managed to attract key players to quite efficiently develop its own system. Interestingly, in the crucial sector of energy, General Electric and Swedish General Electric (ASEA) were affiliated on the boards of Soviet electrical trusts.<sup>236</sup>

On a quantitative point of view, historical consensus considers concessions and technical assistance contracts of limited importance for Soviet Russia. 50 million roubles were roughly invested by foreign concessions, which represents only 2.5% of the foreign investment in joint stock companies in 1913. And concessions contributed to 4% of the total gross output of large-scale industry in 1925/26.<sup>237</sup>

However, on a qualitative point of view, such agreements, especially technical assistance contracts, led to major technology transfer to USSR.<sup>238</sup>

When evaluating the attractivity of concessions and technical assistance contracts for the foreign companies, results are rather negative. While biased Soviet academics estimate that for example Lena Goldfields made 41 kopecks net profit on each gram of gold,<sup>239</sup> Western experts consider that they were evicted when they just started to make profits.<sup>240</sup> The Soviets

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<sup>233</sup> R. Muntig, *op. cit.*, p. 258

<sup>234</sup> E.H. Carr, *Socialism in One Country 1924-1926*, p. 472

<sup>235</sup> R. Muntig, *op. cit.*, p. 263

<sup>236</sup> A.C. Sutton, *Western Technology and Soviet Economic Development 1917 to 1930*, pp. 5

<sup>237</sup> J.P. McKay, "Foreign Enterprise in Russian and Soviet Industry: A Long Term Perspective", p. 352; R.W. Davies, *The Soviet Economy in Turmoil 1929-1930*, p. 33

<sup>238</sup> A.C. Sutton, *Western Technology and Soviet Economic Development 1917 to 1930*, pp. 5; J.P. McKay, "Foreign Enterprise in Russian and Soviet Industry: A Long Term Perspective", p. 352; R.W. Davies, *The Soviet Economy in Turmoil 1929-1930*, pp. 35

<sup>239</sup> A.E. Belousov, *Inostrannye kontsessii Sibiri i dal'nego vostoka v gody NEPa 1925-30* (Foreign concessions in Siberia and the East in the years of NEP 1925-30), pp. 12

<sup>240</sup> A.C. Sutton, *Western Technology and Soviet Economic Development 1917 to 1930*, p. 96

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benefited from the investment, knowledge and work done, which allowed a Soviet foreign trade turnover peak in 1930.<sup>241</sup>

If now specifically focusing on the economic outcome of the British concessions at large, they performed poorly compared to the other nationalities. This certainly results from the British policy. As presented above, some British governments in the 1920s took aggressive measures against Soviet Russia and no government extended ECG to Russian trade before 1930. It seems that UK did not find appropriate to commerce with Soviets while Germany and even USA considered that business was partly separate from political ideology, especially when the Great Depression struck the world but USSR.<sup>242</sup>

#### **4. Expropriation Conditions of Foreign Concessions in the 1920s and -30s**

USSR was aware of its lateness and cleverly adopted a strategy to make this an advantage. Indeed, technology transfer from the West was a way to quickly get functional products or services while avoiding the need of elevated financial and time resources in research and development.<sup>243</sup> At the same time, it was necessary to use propaganda to pretend that foreign support was unimportant. Such method had internal and external benefits. On one hand, the Soviet people remained in the illusion that the principles of the Revolution were delivering promises without the need of capitalism. On the other hand, the official message confused the foreign companies and made them more prone to accept less favourable contractual conditions. Knowing that Soviet police was controlling the population and information, foreign countries had limited or no contradicting sources and thus globally believed the underestimation of the importance of technology transfer.<sup>244</sup>

Lenin accepted pure or mixed foreign concessions as a temporary compromise within the NEP and Stalin ordered the complete cancellation with the start of the First Five Year Plan.<sup>245</sup> More than 350 concessions were liquidated between 1923 and 27 December 1930.<sup>246</sup> On that day the All-Union Soviet of People's Commissars adopted a specific resolution banning concessions but subtly omitting technical-assistance agreements, which were more attractive for USSR. Noteworthy, a few concessions (Danish, Japanese and a single US) remained however after 1935.<sup>247</sup>

To illustrate the aversion of Soviet authorities to concessions, examples are presented below:

*"The difficulties of these [German] firms in the past have been the subject of almost continuous diplomatic correspondence."*<sup>248</sup>

*"Most Polish concessions in the USSR are faring very poorly, for two reasons; namely, the difficulty which the Soviets place in the way of shipment abroad by the concessionaires of their profits and the question of labor..."*<sup>249</sup>

*"[The Soviets] have even gone as far as sabotage in order to discourage the operators."*<sup>250</sup>

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<sup>241</sup> R. Muntig, *op. cit.*, p. 265

<sup>242</sup> R. Muntig, *op. cit.*, p. 266

<sup>243</sup> P.S. Anderson, "The Apparent Decline in Capital-Output Ratios", p. 629; A.C. Sutton, *Western Technology and Soviet Economic Development 1917 to 1930*, p. 4

<sup>244</sup> A.C. Sutton, *Western Technology and Soviet Economic Development 1917 to 1930*, pp. 9; N. Liubimov, "The Soviets and Foreign Concessions", p. 95

<sup>245</sup> A.C. Sutton, *Western Technology and Soviet Economic Development 1930 to 1945*, pp. 17

<sup>246</sup> Translation of the resolution in U.S. State Dept. Decimal File, National Archives Microcopy 861, Roll 602, Frame 237, Riga Consulate Report No. 8019, 4 September 1931

<sup>247</sup> A.C. Sutton, *Western Technology and Soviet Economic Development 1930 to 1945*, pp. 16

<sup>248</sup> U.S. State Dept. Decimal File, Report 936, Berlin Embassy, 26 May 1931

<sup>249</sup> U.S. State Dept. Decimal File, National Archives Microcopy 861, Roll 602, Frame 211, Warsaw Legation Report, 8 February 1930



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Prior to the resolution of 27 December 1930, methods to eliminate concessions consisted of expropriation by physical force or economic pressure, harassment and taxation. Such approaches could be used individually or combined.

Expropriation by sole physical force was not common. In the 1923 case of the Caucasian-American Trading and Mining Company, a Delaware Corporation with a concession in Soviet Georgia, employees were arrested, books seized, some agricultural material destroyed and the remaining live-stock looted.<sup>251</sup>

Economic pressure was preferred. Such methods included customs delay, currency-export restrictions, union actions or change in credit policy.<sup>252</sup> Economic pressure was sometimes combined to alleged breach of contract as exemplified in a case involving the German company International Warenaustausch Aktiengesellschaft that was specialized in egg packaging and exporting to Germany.<sup>253</sup> Soviet authorities decided to block exports for unclear reasons. As agreed in the concession contract, the company called for an action before the Moscow arbitration court but the only German arbitrator of the three-man court was arbitrarily replaced by a third Russian member and unsurprisingly the German company lost the case. USSR even tried to enforce the decision in German courts but the latter denied the judgement 'on the grounds that the elimination of the German member of the Court of Arbitration had taken place illegally and without due course'.<sup>254</sup> However, as Soviet Union managed to delay the case by initiating an appeal in the Berlin Kammergericht and in parallel a damage suit in the Berlin Landgericht, the company 'despairing of a definite settlement within a reasonable time,' went into bankruptcy.<sup>255</sup>

As harassment was less visible than physical expropriation, it ended up as a weapon of choice.<sup>256</sup> Tetuikhe Mining Corporation concession, the largest mining concession after Lena Goldfields Ltd, disappeared after liquidation on 26 December 1931: '... in 1930 the Soviet Government having forced the Lena Goldfields concessionaires out of the USSR began a campaign against the Tetuikhe Corporation, and published reports alleging that it had been in conflict with its workmen. Eventually, at the end of last December, the corporation suspended operations...' <sup>257</sup>

Taxation appeared as an extremely efficient tool against profitable concessions, especially when combined to the use of force.<sup>258</sup> In the case of the Latvian Richard Kablitz Company, a concession specialized in the manufacturing of stokers, economizers and boilers within six plants in the URSS, authorities forbade the private entity to transfer a part of its profits abroad in June 1926. As the company on its side respected the conditions of the concession contract and paid taxes, breach was unilateral. Negotiation was privileged and the enterprise was allowed to export 40,000 rubles per year. However, the mandatory export certificates were neither delivered in 1928 nor in 1929. The latter year, an extra 'normative tax' of 300,000 gold rubles was suddenly requested in exchange of the export certificate for 40,000 rubles. The

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<sup>250</sup> U.S. State Dept. Decimal File, National Archives Microcopy 861, Roll 602, Frame 210, Warsaw Legation Report, 13 January 1930

<sup>251</sup> Claims against the Soviet Union by the United States, U.S. National Archives Microcopy T 640, Roll 2 (end) and Roll 3 (start)

<sup>252</sup> A.C. Sutton, *Western Technology and Soviet Economic Development 1930 to 1945*, p. 19

<sup>253</sup> U.S. State Dept. Decimal File, Microcopy 861, Roll 602, Frames 204, Report 373, Berlin Embassy, 14 July 1930

<sup>254</sup> U.S. State Dept. Decimal File, Microcopy 861, Roll 602, Frames 216, April 1930

<sup>255</sup> *Sevodnia* newspaper, No. 39, Riga, 8 February 1931; U.S. State Dept. Decimal File, Microcopy 861, Roll 602, Frames 233, 16 February 1931, and Report No. 7506, Riga

<sup>256</sup> A.C. Sutton, *Western Technology and Soviet Economic Development 1930 to 1945*, p. 22

<sup>257</sup> U.S. State Dept. Decimal File, Microcopy 861, Roll 602, Frames 244, Report No. 89, Riga Consulate, 26 February 1932

<sup>258</sup> A.C. Sutton, *Western Technology and Soviet Economic Development 1930 to 1945*, p. 102

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company could not resist to such demand and thus was liquidated. In parallel, it attempted in vain to request compensation for unfair exploitation of its patents.<sup>259</sup>

## C. Lena Goldfields Case

### 1. Lena Goldfields and its 1925-1929 Concession

The British Lena Goldfields Ltd concluded on 30 April 1925 the largest concession in terms of investment in the history of USSR.<sup>260</sup> 22 million rubles (i.e. £2.25 million) were required and in 1929 such investment had already reached £3.5 million thanks to a bank consortium including notably Deutsche Bank of Germany and Blair & Company of New York.<sup>261</sup>

The concession included thirteen separate Soviet industrial complexes, which were operated prior to the nationalisation without compensation of all Russian mines in July 1918 by (i) Lenzoloto (the former Russian subsidiary of Lena Goldfields Ltd between 1908 and 1918) in the Lena region, by (ii) Altai District Mining company, Sissert Company Limited and the Pavda Company in the Altai and Ural mountain regions. Such complexes consisted of:<sup>262</sup>

- Mainly the gold mines of the Lena-Vitim rivers in Siberia;
- Copper, lead and zinc deposits on the Irtysh river
- Kiselov coal mines in Volgograd province;
- Sysert copper mines, and copper and iron smelters in the Ural mountains;
- Yegoshin anthracite mines in the Urals;
- Copper and iron smelters at Revdinsky in the Urals;
- Degtiarinsky copper mines in the Urals;
- Gumeshevsky copper smelter in the Urals;
- Wire- and nail-making factories in the Urals;
- Lead, zinc and silver mines, and lead and zinc smelters in Zirianovsky, Zmeynogorsky and Pryitishky districts;
- Nikolopavdinsky platinum mines in the Ural mountains (such mines were part of the pre-revolutionary concession but Lena Goldfields documents did not refer about them);
- Bodaybo railroad and shipping system in Lena-Vitim region, and Degtiarinsky railroad (under a different agreement with the People's Commissariat of Ways and Communications).

The concession was granted for a period of thirty years regarding the Lena gold mines and fifty years for the other sites.<sup>263</sup> It was required that the annual production would reach at least 420 pudys of gold, 1,000 pudys of silver, one million pudys of copper, 600,000 pudys of zinc, and 180,000 pudys of lead.<sup>264</sup> No report of failure to meet such production were found. In fact, the concession proved to be of crucial importance for Soviet exports and thus national economic development in the 1920s. It extracted 2.73 kg of gold per worker per year when the Soviet national average was at 0.52. As the most efficient entity, it annually produced more than 30% of Soviet gold per year. In exchange of a 7% royalty on the total production of gold, Lena Goldfields Ltd enjoyed freedom to: operate; manage; export surplus duty-free; and hire/fire personnel. Moreover, social insurance and railroad transport were at rates identical to

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<sup>259</sup> *Ibid.*, p. 22

<sup>260</sup> *Ibid.*, p. 8. Note that the concession agreement entered into force on 11 August 1925

<sup>261</sup> *Izvestia* No. 69, 26 March 1926

<sup>262</sup> Annex 4 - Location of the activities of Lena Goldfields Company Ltd ; A.C. Sutton, *Western Technology and Soviet Economic Development 1917 to 1930*, p. 95

<sup>263</sup> A.C. Sutton, *Western Technology and Soviet Economic Development 1917 to 1930*, p. 95

<sup>264</sup> *Ibid.*, p. 24; Pood (plural: pudy or pudy) was a mass unit of approximately 16.38 kilograms that was used in Russia, Belarus, and Ukraine from the 12<sup>th</sup> century. Like other units of the Imperial Russian weight measurement system, USSR officially abolished pood in 1924. However, the term remained in widespread use at least until the 1940s.

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those of government companies. More importantly, the control over real property was practically unlimited in the concession.<sup>265</sup>

In addition, the concession agreement specified that Lena Goldfields Ltd agreed to waive any claims for compensation against the 1918 Soviet nationalisation of Lena Goldfields mines<sup>266</sup> and guaranteed to indemnify USSR in the event of claims by Lena Goldfields' Russian subsidiaries. In September 1926, after the concession-agreement ratification, Lena Goldfields Ltd requested the withdrawal all its 1921 claims before the Russian Claims Department. Noteworthy, to avoid any conflict with the former shareholders of Lenzoloto, Altai District Mining company, Sissert Company Limited and the Pavda Company (and in a putative perspective of ejection of Soviet power in Russia), Lena Goldfields Ltd begun in late 1923 to buy these shares at a low price to exiled and financially constrained Russians. Indeed, following a controversial attitude, Lena Goldfields Ltd did not mention that a concession agreement was under discussion with USSR.<sup>267</sup>

While Lena Goldfields Ltd performed all the requirements of the concession agreement; USSR breached it by not giving access to all the properties included in articles 1 and 2 of the concession agreement.<sup>268</sup> In addition, contrary to article 20 of the concession agreement, the Soviet government did not grant Lena Goldfields Ltd free sale of gold on the London gold market.<sup>269</sup> Subsequently, troubles gradually started in April 1928. First, Soviet journals criticized Lena Goldfields Ltd for using private prospectors (*starateli*).<sup>270</sup> Such workers were allowed by the concession agreement and existed in public mines but the attack was rather a warning. In 1929, while the media campaign against capitalist concessions continued, Lena Goldfields Ltd could not finance, for the period covering the years 1928 and 1929, the expected one million rubles royalties as the government restricted gold exportations and defined gold price at approximately one-fourth of the market price. Soviets then claimed that not complying with minimal royalties corresponded to a non-fulfillment of article 39 of the concession agreement. Noteworthy, such actions started when the Lena Goldfields Ltd had completed in 1928-1929 the technical reconstruction (including the installation of a recent dredge) as well as the expansion of plants in the concession.<sup>271</sup> Because of the Soviet pressure, the position of Lena Goldfields Ltd became unstable; its English and foreign creditors could request its liquidation in the English Companies Court.<sup>272</sup>

In December 1929, the aggressive methods escalated. Twelve employees were arrested, four were later found guilty of espionage and the media campaign was made global.<sup>273</sup> OGPU, the Central Committee of the Party, the trade unions, and *Glavkontsesskom*<sup>274</sup> combined actions, such as harrassment and ejection of Lena Goldfields Ltd's personnel, simultaneous raids and sabotage in all company's complexes, counter-revolutionary propaganda and summon of royalties payment within four months.<sup>275</sup> The company quantified that around 30%-

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<sup>265</sup> A.C. Sutton, *Western Technology and Soviet Economic Development 1917 to 1930*, p. 96

<sup>266</sup> See p. 8 of the present manuscript.

<sup>267</sup> V.V. Veeder, "The Lena Goldfields arbitration: The historical roots of three ideas", p. 757

<sup>268</sup> Lena Goldfields Ltd was thus forced to import fire clay (i.e. refractory clays) and limestone (essential as a smelter flux) at great cost from Germany.

<sup>269</sup> A.C. Sutton, *Western Technology and Soviet Economic Development 1930 to 1945*, p. 24. Note that selling gold abroad was punishable by death.

<sup>270</sup> *Ekonomicheskaya Zhizn*, No. 93, 21 April 1928

<sup>271</sup> A.C. Sutton, *Western Technology and Soviet Economic Development 1930 to 1945*, p. 24

<sup>272</sup> V.V. Veeder, *op. cit.*, p. 762

<sup>273</sup> A.C. Sutton, *Western Technology and Soviet Economic Development 1930 to 1945*, p. 25

<sup>274</sup> *Glavkoncesskom* was the Main Concessions Committee, which was supervised by the Supreme Economic Council, that was itself under the control of the Council of People's Commissars.

<sup>275</sup> U.S. State Dept. Decimal File, Microcopy 861, Roll 63—Lena Goldfields Ltd., Frame 18, 13 January 1930, Warsaw Report; A. Nussbaum, "Arbitration Between the Lena Goldfields Ltd. and the Soviet Government", 1950, pp. 32

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40% of extracted gold was stolen. As police protection was not granted, USSR breached articles 35 and 80 of the concession agreement.<sup>276</sup>

Globally, from 1925 to 1929, Lena Goldfields Ltd invested £3.5 million (which was above the concession agreement conditions) to develop the concession, while its gold production was paid £760,390 according to Russian reduced prices (but it would have been valued £3.6 million at London's prices) and only £170,000 of profit was repatriated to London.<sup>277</sup>

## 2. Chronological Phases of the Arbitration

As the Lena Goldfields Ltd's protests remained unheard and its activities in USSR appeared impossible, the company's chairman sent a telegram to the Soviet Supreme Economic Council on 12 February 1930 in order to call for arbitration. The text did not request termination of the agreement. It also informed that it had appointed Sir Leslie Scott<sup>278</sup> as its arbitrator. It is important to note that directors of the nearly insolvent Lena Goldfields Ltd were concerned by satisfying mainly the company's creditors and possibly part of the shareholders.<sup>279</sup>

The Soviet Politburo via the chairman of the Main Concessions Committee answered by telegram on 25 February 1930. Dr Semyon Borisovich Chlenov (Soviet legal adviser attached to the USSR Embassy in Paris, and specialized in foreign trade and international arbitration) was the appointed USSR's arbitrator and the counterclaim cited 31 articles of the concession agreement but article 86. There, as a tactical move, the request to terminate the concession agreement without compensation due to Lena Goldfields' non-payment of royalties was not mentioned even though it was planned. Indeed, on 25 February 1930, the Politburo confirmed that all foreign concessions should be terminated and some like Lena Goldfields Ltd had to 'be liquidated in the more or less immediate future, at the appropriate political moment'.<sup>280</sup> Such position was confirmed by external opinion: "[Real reasons] lay in the fact that the time had now come when the enterprise was about to yield profits for the concessionaires and that difficulties had arisen in connection with the transfer of these profits to foreign countries."<sup>281</sup>

On 9 May 1930, following controversies with the selection of the chairman within the Freiberg Mining Schools in Saxony or the King's Mining School in Stockholm,<sup>282</sup> the arbitration court, chaired by Dr. Otto Stutzer (Professor of Fuel Geology at the Freiberg School of Mines), was established in Berlin. The following day, USSR ordered its arbitrator to end its duty. As the chairman reminded that only the tribunal could dissolve itself, the hearings continued. In parallel, the Soviet government unilaterally decided to take over steamships and other means of transportation of the concession.<sup>283</sup> From 19 June 1930 on, the procedural hearings took

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<sup>276</sup> Paragraph 21(d) of the Lena Goldfields award (see Annex 7 - Text of the Award in the Lena Goldfields Company Ltd Arbitration, 3 September 1930)

<sup>277</sup> V.V. Veeder, *op. cit.*, p. 761

<sup>278</sup> Sir Leslie Scott was a senior English barrister, a former Conservative representative at the British parliament (1910-1929) and Solicitor-General in Lloyd George's coalition government (March to October 1922).

<sup>279</sup> V.V. Veeder, *op. cit.*, p. 763

<sup>280</sup> *Ibid.*, p. 765

<sup>281</sup> U.S. State Dept. Decimal File, National Archives Microcopy 861, Roll 5017 – Living Conditions, Frame 163

<sup>282</sup> The parties could commonly choose the chairman under Article 90(B) of the Concession Agreement. However, during the negotiations in Moscow in March 1930, Lena Goldfield Ltd suggested the Swedish lawyer Dr E. Loeffgren or the Swiss Professor Eugene Borel, while USSR preferred the German Professor Albert Einstein, Director of the Kaiser Wilhelm Institute for Physics at the Berlin University. As no agreement was reached, under Article 90(C) of the Concession Agreement, Soviet Union submitted on 26 March 1930 a list of six candidates from the Freiberg Mining Academy, including Dr. Otto Stutzer. USSR realized too late that Professor Otto Stutzer had opposing opinions against the Five-Year Plan. On 7 April 1930, Lena Goldfield Ltd selected Professor Otto Stutzer.

<sup>283</sup> A.C. Sutton, *Western Technology and Soviet Economic Development 1917 to 1930*, p. 99

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place in London at the Royal Courts of Justice in the Strand.<sup>284</sup> On 7 August 1930, the hearings showed that Lena Goldfields Ltd had fulfilled on its side the terms of the agreement.<sup>285</sup> Finally, on 2 September 1930, the truncated tribunal awarded a massive monetary compensation of £12,965,000 (i.e. £8,500,000 plus 12% interest) to the English company and dissolved the concession agreement.<sup>286</sup> As Soviet Union remained silent and did not transfer any contribution, Lena Goldfields Ltd made weekly addresses to the English Government in the House of Commons. Long negotiations initiated in 1933 while a limited agreement, unrelated to the award, was made possible in 1935.<sup>287</sup> In the end, in 1992, the UK covered the remaining unpaid amount of this limited agreement (see below for further development).

## **D. Key Legal Aspects<sup>288</sup>**

### **1. General Principles of Law**

Based on Article 90(A) of the 1925 Concession Agreement<sup>289</sup>, any dispute related to the interpretation or performance of this agreement had to be 'examined and settled by an arbitration court'. Moreover, Article 89 stated that 'the parties base their relations with regard to this agreement on the principle of good will and good faith, as well as reasonable interpretation of the terms of the agreement'. Thus, suspension or annulment of the concession was included in the arbitration clause.<sup>290</sup> However, comments of the Soviet legal advisers to the Supreme Economic Council stated that in 1925 at the time of the Concession Agreement the 1917 Soviet law was not allowing private agreement to refer future disputes to arbitration. Moreover, USSR was not bound to the League of Nations' 1923 Geneva Protocol on Arbitration Clauses.<sup>291</sup> Such opinion quickly appeared invalid as the 1920 Decree of the Council of People's Commissars on Concessions guaranteed that the foreign concessionaire's property would not be liable to nationalisation, confiscation or requisition and that no unilateral changes would be made by any regulations or decrees of the government to the terms of the concession agreement. As stated on 30 July 1925 by the Lena Goldfields Ltd's chairman: 'we are advised that the concession is equivalent in law to a private Act of Parliament in this country'.<sup>292</sup> Moreover, Article 86(A) of the 1925 Concession Agreement ordered that "The concession shall only be terminated before its time by a decision of the arbitration court".<sup>293</sup> Indeed, on 25 February 1930 the Government's answer to Lena Goldfields Ltd's claim for arbitral decision was not criticized on that point.

As London was defined as the place of arbitration and Lena Goldfields Ltd an English legal person, English law would apply as *lex loci arbitri*. According to section 19 of the English Arbitration Act of 1889, an arbitration tribunal could be created at any stage of the proceedings 'to state in the form of a special case for the opinion of the Court any question of law arising in the course of the reference'.<sup>294</sup> However, even though there was no express provision on applicable law in (i) the concession agreement, (ii) the notice of arbitration of 12 February 1930

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<sup>284</sup> V.V. Veeder, *op. cit.*, p. 780

<sup>285</sup> A.C. Sutton, *Western Technology and Soviet Economic Development 1917 to 1930*, p. 99

<sup>286</sup> The award was in German but an English version was offered to the press. A. Nussbaum, *op. cit.*, pp. 33

<sup>287</sup> A. Nussbaum, *op. cit.*, pp. 34

<sup>288</sup> Annex 7 - Text of the Award in the Lena Goldfields Company Ltd Arbitration, 3 September 1930

<sup>289</sup> Annex 6 - Article 90 of the 1925 Lena Goldfields Concession Agreement: The Arbitration Clause

<sup>290</sup> A. Nussbaum, *op. cit.*, pp. 40

<sup>291</sup> Editors of the American Journal of International Law, "Protocol on Arbitration Clauses in Commercial Matters", *The American Journal of International Law*, Vol. 20, No. 4, pp. 194

<sup>292</sup> V.V. Veeder, *op. cit.*, pp. 759

<sup>293</sup> A. Nussbaum, *op. cit.*, p. 39

<sup>294</sup> V.V. Veeder, *op. cit.*, pp. 749

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or (iii) its statement of claim on 27 May 1930<sup>295</sup>, the tribunal did not limit its methodology to English procedure and English private international law.

As one of the first examples in legal history, the arbitrators referred to general principles of law, notably Article 38(I)(c) of the Statute of the Permanent Court of International Justice (PCIJ).<sup>296</sup> Indeed, initially the tribunal named the Soviet Union's breach of the concession agreement as a repudiatory breach of contract (according to the English legal term) but later adopted the Lena Goldfields Ltd's argument of unjust enrichment.<sup>297</sup> During the hearings in August 1930, Lena Goldfields Ltd highlighted that (i) the 1925 concession agreement and amendments had been signed by the Executive Government of Russia and by the Acting Commissary of Foreign Affairs", and (ii) "that many of the terms of the contract [notably Articles 86 and 90] contemplated the application of international rather than merely national principles of law". Such move was crucial, as English law was not fully recognising the principle of unjust enrichment at that time.<sup>298</sup> The tribunal also admitted Lena Goldfields Ltd's suggestion that Soviet law was applicable in parallel but only to the contractual interpretation and performance by both parties for the 'domestic matters in the USSR'.<sup>299</sup> This dual decision appears unusual as suggested by Nussbaum: "such a splitting of applicable legal systems was not warranted; the 'proper law' of the entire contract was Soviet".<sup>300</sup> However, this duality in juridical nature already existed in the concession agreement under Soviet law: on one hand, the decree of the USSR Council of People's Commissars as a *lex specialis* exempted the concession from the general law, and on the other hand existed the bilateral agreement of the Soviet Union and the concessionaire. Thus, the obligation to fulfil a planned production created a public law condition while the handing-over of nationalised plant to a concessionaire was depending on private law.<sup>301</sup> Regarding the Lena Goldfields Ltd's suggestion (that were followed by the tribunal), it replaced Soviet law by the general principles of law for the private claim of unjust enrichment while the application of Soviet law as public law remained for the concession agreement's interpretation, internal performance and domestic matters. This internationalisation of a transnational contract appeared a major change in international investment arbitration. The tribunal was defining by itself its own procedure and own substantive law.<sup>302</sup>

## 2. Expropriation Compensation

The tribunal preferred to rely on Scots law (and referred to German Civil Code, French and Soviet law on the basis of the general principle of law) to find a solid ground for restitution of unjust enrichment.<sup>303</sup> Noteworthy, it did not invoke public international law.<sup>304</sup> Then, to define the compensation, the value of the concession had to be quantified. As Lena Goldfields Ltd was a concessionaire and not the owner of the mines, asset-based valuation was irrelevant. The tribunal selected the "discounted-cash flow method", such compensation on the lost profits

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<sup>295</sup> *Ibid.*, p. 765

<sup>296</sup> Article 38(I)(c) of the Statute of the PCIJ of 16 December 1920 reads as follows: '1. *The Court, whose function is to decide in accordance with international law such disputes as are submitted to it, shall apply: c. the general principles of law recognized by civilized nations*'.

<sup>297</sup> V.V. Veeder, *op. cit.*, p. 766

<sup>298</sup> *Ibid.*, p. 766

<sup>299</sup> *Ibid.*, p. 767

<sup>300</sup> *Ibid.*, p. 768

<sup>301</sup> *Ibid.*, p. 771

<sup>302</sup> *Ibid.*, p. 772

<sup>303</sup> Paragraph 23 of the Lena Goldfields award (see Annex 7 - Text of the Award in the Lena Goldfields Company Ltd Arbitration, 3 September 1930) referred to the British House of Lords in the Scotch case of *Cantiare San Rocco S.A. v. Clyde Shipbuilding Company, Limited*, 1924 Appeal Cases, p. 226; V.V. Veeder, *op. cit.*, pp. 751.

<sup>304</sup> Case Concerning the Factory at Chorzow (Germany v Poland), Permanent Court of International Justice 1928 Series A No. 9. There, the Polish government had to compensate two German companies for its method of seizure of the nitrate factory located at Chorzów in Upper Silesia.

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consisted in the total of the annual income of the concession multiplied by the remaining number of years according to the concession agreement. The tribunal considered that Lena Goldfields Ltd fully complied with the principles of good commercial management, the best technical skill and up-to-date development, thus no reduction of the compensation was due.<sup>305</sup>

### 3. Truncated Tribunal

After the date of the first meeting of the tribunal was defined but prior to this date, the Soviet Union informed the tribunal that it disregarded the procedure, alleging that Lena Goldfields Ltd had ceased to financially comply with the concession agreement. In addition, USSR ordered its arbitrator to not attend the initial meeting.<sup>306</sup> Therefore, the tribunal was truncated.

According to the 1930 English common law only a complete tribunal was valid to rule.<sup>307</sup> However, the 1927 McKinnon Committee, which led to the adoption of the 1934 Arbitration Act, recommended to allow an award from a tribunal made of two out of three arbitrators.<sup>308</sup>

Fortunately for Lena Goldfields Ltd, Article 90(F) of the Concession Agreement specified that a truncated tribunal could proceed.<sup>309</sup> If at the first session, one party did not send its appointed arbitrator, in the absence of insuperable obstacles, the other party may request the dispute to be the chairman and the remaining arbitrator.<sup>310</sup>

Noteworthy, the retraction of USSR might be explained by the following facts: (i) the Lena show-trials and harassment campaign in USSR led Lena Goldfields Ltd to declare before the first arbitration meeting that it was abandoning its concession (thus, the arbitration was useless, as USSR had regained full control of the concession); (ii) the Soviet Union realized too late that the chairman of the tribunal had an opposing opinion to communism; (iii) the scope of the tribunal was too limited as it was not considering the unilateral termination of the concession agreement by Lena Goldfields Ltd.<sup>311</sup>

On 9 May 1930, at the first procedural hearing in Berlin, the allegation that Lena Goldfields Ltd had cancelled the whole concession agreement and thus the arbitration was not validated. The tribunal ruled that according to Article 86 of the Concession Agreement only itself could terminate the concession.<sup>312</sup>

### 4. Procedural and Jurisdictional Issues

USSR's main complain in its telegram of 5 May 1930, i.e. after the creation of the tribunal, was that the tribunal was made to analyse the problem of implementing the concession agreement and not quantifying the losses resulting from the termination of the concession. Soviet Union viewed the expertise in geology of the tribunal's chairman as pertinent for the first option while an accountant, an economist or a lawyer would have been more appropriate for the second option. Thus, for USSR, appointing a different arbitration tribunal in accordance with the Concession Agreement to resolve the dispute over termination looked to be the relevant approach.<sup>313</sup>

The tribunal considered that its scope was already well defined and could not include a novel claim, which laid outside its jurisdiction. The arbitration tribunal based its scope of jurisdiction on the three telegrams sent prior to its own creation: the Lena Goldfields Ltd's telegram of 12 February 1930 and the two Soviet telegrams of 25 February and 1 March 1930. There, the dissolution of the Concession Agreement, the termination of the concession or

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<sup>305</sup> V.V. Veeder, *op. cit.*, p. 751

<sup>306</sup> *Ibid.*, pp. 779

<sup>307</sup> In 1930, an English arbitration had to refer to the 1889 Arbitration Act.

<sup>308</sup> Sir Frank Douglas MacKinnon committee report, Report of Committee on the Law of Arbitration (Cmd 2817), 1927

<sup>309</sup> Annex 6 - Article 90 of the 1925 Lena Goldfields Concession Agreement: The Arbitration Clause

<sup>310</sup> V.V. Veeder, *op. cit.*, pp. 773

<sup>311</sup> *Ibid.*, pp. 774

<sup>312</sup> *Ibid.*, pp. 780

<sup>313</sup> *Ibid.*, pp. 782

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reference to Article 86 of the Concession Agreement did not appear. Therefore, USSR complain was irrelevant.<sup>314</sup>

Based on Article 90(H) and Article 90(K) of the Concession Agreement, Lena Goldfields Ltd's mentioned on the first procedural hearing on 9 May 1930 and expressly pleaded in its Statement of Claim on 23 May 1930 that the concession termination was to be included within the scope of the original dispute. There, the tribunal accepted and USSR publicly complained about this scope enlargement (even though it had already refused to be part of the trial). In fact, the arbitration tribunal did not analyse the doctrine of separability (i.e. the survival of the tribunal after the termination or alleged termination of the concession agreement), as it ruled on 9 May 1930 that during the trial the concession agreement remained valid according to Article 86 of the Concession Agreement.<sup>315</sup>

Furthermore, on 9 May 1930, the arbitration tribunal had to respond to USSR's criticism of the tribunal's competence. The arbitrators, according to the dominant view (since 1796 in England<sup>316</sup>), ruled that only the tribunal retained the ability to evaluate its own competence.<sup>317</sup>

## 5. Other Aspects

Noteworthy, no provisional measures were taken during the procedure. The speed was privileged to reach a final decision. As an early case of investment arbitration, the present case created attractiveness of arbitration as the dispute settlement took less than seven months from the arbitration notice to the final award.<sup>318</sup>

The arbitration tribunal appeared practical, as the circumstances of the expropriation did not allow the use of evidences that remained or were confiscated in USSR. Thus, the "second-best evidence rule" applied. The tribunal also innovated by accepting evidences not only orally but also in writing by affidavit.<sup>319</sup>

The tribunal accepted the creation of contractual interest after the award while English law was not allowing it at that time.<sup>320</sup>

Interestingly, the tribunal disregarded the principle of privacy and confidentiality by allowing the press to assist during the hearings. Moreover, it used the London Times to make the award public.<sup>321</sup> By doing so, the tribunal was sure that USSR could not pretend being not informed. However, this manoeuvre did not pressure enough Soviet Union to pay the award.

## 6. Enforcement

Following the publication of the award, the Politburo met on 6 September 1930 and officially stated that the decision would not be commented. The government preferred to be active by ordering a press campaign of defamation.<sup>322</sup>

On its side, Lena Goldfields Ltd quickly realized that the award could neither be enforced in English courts, nor in Soviet courts (or any other national courts on the planet). The Soviet Union was legally isolated from the rest of the world. Regarding the UK more specifically, the 1921 Anglo-Russian Trade Agreement<sup>323</sup> and the 1930 UK-USSR Temporary Trade Agreement provided no ground for recognition of an arbitration award. Thus, Lena Goldfields Ltd lobbied and publicized the case to activate diplomatic channels. Such approach proved to

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<sup>314</sup> *Ibid.*, p. 784

<sup>315</sup> *Ibid.*, pp. 784

<sup>316</sup> Lord Loughborough, Lord High Chancellor of Great Britain, in cases of the the Jay Treaty (formally known as the 1795 Treaty of Amity, Commerce, and Navigation, Between His Britannic Majesty and the United States of America). Footnote in V.V. Veeder, *op. cit.*, pp. 752

<sup>317</sup> V.V. Veeder, *op. cit.*, pp. 752

<sup>318</sup> *Ibid.*, pp. 753

<sup>319</sup> *Ibid.*, p. 754

<sup>320</sup> *Ibid.*, p. 754

<sup>321</sup> *Ibid.*, p. 754

<sup>322</sup> *Ibid.*, pp. 786

<sup>323</sup> Annex 5 - Trade Agreement Between His Britannic Majesty's Government and the Government of the Russian Socialist Federal Soviet Republic, 16 March 1921



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be demanding as UK-Soviet diplomatic relations were cold since the 1927 ARCOS affair.<sup>324</sup> The Lena show trials in January-April 1930 and the Metro-Vickers show trials in 1933 and the Soviet violations of the 1930 UK-USSR Temporary Commercial Agreement complexified the Anglo-Soviet relation. Parallel pressure occurred, as Lena Goldfields Ltd had to negotiate its financial viability with its German creditors and discreetly with the German government.<sup>325</sup>

Subsequently, the context of the UK-USSR Trade Agreement of February 1934 combined to the first visit to Soviet Moscow of a British minister, i.e. Robert Anthony Eden, 1<sup>st</sup> Earl of Avon, in March 1935 led to a modest agreement (not referring to the arbitration award) for the benefit of Lena Goldfields Ltd: the Soviet Union agreed to pay £50,000 upfront and £2.95 million over 20 years from 1 May 1935 to 1 November 1954, without interest.<sup>326</sup> However, after a cumulated payment of £1,067,500, USSR stopped in November 1940, arguing that UK was unlawfully requisitioning or sequestering material from the former Baltic States that had been already annexed by the Soviet Union in June 1940. Later, via the 1968 UK-USSR Agreement, Lena Goldfields Ltd managed to collect £5.8 million but such assets were questionable.<sup>327</sup> Thus, in the end, in January 1992, UK compensated the remaining amount of the 1935 Lena Goldfields Ltd settlement. Note, however, that the English High Court formally dissolved the company in 1976.<sup>328</sup>

### III. The Yukos Shareholders Cases

#### A. Global Historical Context

The Yukos shareholders cases cannot be understood without grasping the historical and political evolution of Russia at the transition of the 20<sup>th</sup> and 21<sup>st</sup> centuries. Contrary to the period of the Lena Goldfields case, the Russian state switched from Communism to Capitalism. Such drastic change strongly impacted the population and its standard of living. While some political forces considered wide liberalism the novel norm, others countered such attitude by restoring authoritarian and centralized control. The analysis will thus cover the first steps of transition in the 1990s to the restoration of some political strength under the Putin ruling via the political and economic collapse of the Yeltsin years.<sup>329</sup> The present part will be divided in the three consecutive sections: Gorbachev era (11 March 1985 - 25 December 1991); Yeltsin era (25 December 1991 - 31 December 1999); and the first two terms of the Putin era (31 December 1999 - 2 March 2008).

#### 1. Gorbachev Era (11 March 1985 - 25 December 1991)

Compared to the (exaggerated) Soviet official publications, real growth rate consistently declined from the 1960s in the USSR.<sup>330</sup> Gradual asphyxiation of the economy took place. While no problem of unemployment existed, the soviet system failed to induce economic growth in order to cover increasing expenses and to allow abundance. Contrary to capitalism,

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<sup>324</sup> Refer to p. 18 and to a lower extent to p. 15 of the present manuscript.

<sup>325</sup> V.V. Veeder, *op. cit.*, p. 787

<sup>326</sup> *Ibid.*, p. 788

<sup>327</sup> According to article 4 of the 1968 UK-USSR Agreement concerning the Settlement of Mutual Financial and Property Claims (Cmnd 3517), the UK government "*undertakes further, that, from the assets indicated in Article 2, it will make a settlement, along with other claims, of claims by the holders of unredeemed Notes issued by the Government of the Union of Socialist Republics to the British joint stock companies, the Tetiue Mining Corporation and Lena Goldfields Ltd of London, irrespective of the nationality of such holders*". As such assets of article 2 consisted in gold bullion held by the Bank of England but officially belonging to the central banks of Latvia, Lithuania and Estonia, these countries requested the return of these assets at the time of their independence in August 1991. Through the controversial Foreign Compensation Act 1968, UK compensated the Baltic states.

<sup>328</sup> V.V. Veeder, *op. cit.*, pp. 788

<sup>329</sup> Annex 8 - Russian GDP from 1989 to 2016 and crude oil price from 1861 to 2014

<sup>330</sup> S. Rosefielde, *The Russian economy: From Lenin to Putin*, p. 116

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it neither grasped the importance of the supply and demand principle nor the opportunity of the large diffusion of new technologies.<sup>331</sup>

The first attempt of reform under Nikita Sergeyevich Khrushchev<sup>332</sup> was too limited to optimize the system.<sup>333</sup> Then, the rigid ruling of Leonid Ilyich Brezhnev<sup>334</sup> followed by the short terms of Yuri Vladimirovich Andropov<sup>335</sup> and Konstantin Ustinovich Chernenko<sup>336</sup> froze the structure.<sup>337</sup> To desperately dynamize USSR, the highest committee of USSR, the Politburo, decided to elect the relatively young Mikhail Sergeyevich Gorbachev (54 year-old at that time) as general secretary of CPSU<sup>338</sup> on 11 March 1985 only three hours after Chernenko passed away.<sup>339</sup>

To stop the *zastoi* (stagnation) of the state planned economy, Gorbachev suggested the *uskoreniye* (acceleration) of social and economic development at the Soviet Party Plenum of 20 April 1985.<sup>340</sup> The principle focused on increased industrial and agricultural productivity notably via technological modernization and bureaucracy reform. It later also included the concept of *gospriyomka* (state acceptance of production, i.e. quality control).<sup>341</sup> Such vague approach with limited practical actions did not produce significant effect.<sup>342</sup> However, as exemplified with the anti-alcohol campaign, it showed that Gorbachev promoted change in favor of the good of the population.<sup>343</sup>

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<sup>331</sup> S. Rosefielde, *op. cit.*, p. 160

<sup>332</sup> Nikita Sergeyevich Khrushchev as political commissar during Russian Civil War and WWII and later as an adviser to Stalin grew in political influence. However only 6 months after the death of Stalin he was appointed First Secretary of the CPSU on 14 September 1953. After promoting de-Stalinization and attempting reforms, he was overthrown by a coup d'état-like move on 14 October 1964.

<sup>333</sup> W.J. Tompson, *Khrushchev: A Political Life*, pp. 198

<sup>334</sup> Leonid Ilyich Brezhnev ended WWII with the rank of major general and subsequently in 1952 became a member of the Central Committee. From 14 October 1964 until his death on 10 November 1982, he controlled USSR as the First (and later General) Secretary of the CPSU. The growth of the military industrial complex during his tenure increased the international influence of the Soviet Union. However, his internal policy was remembered as an era of economic and social stagnation.

<sup>335</sup> After being Chairman of the KGB from 1967 to 1982, Yuri Vladimirovich Andropov ruled USSR as General Secretary of the CPSU from 2 November 1982 until his death on 9 February 1984. While externally Andropov continued the Cold War, internally he attempted to raise management effectiveness in order to improve the economy without changing the principles of command economy.

<sup>336</sup> Konstantin Ustinovich Chernenko was immersed in the Central Committee administration since 1965 before being elected as the General Secretary of the CPSU from 13 February 1984 until his death on 10 March 1985. His ruling was a return to the policies of the late Brezhnev era.

<sup>337</sup> Editors of Encyclopædia Britannica, *Mikhail Gorbachev*

<sup>338</sup> CPSU was the founding and sole governing party of USSR according to Article 6 of the 1977 Soviet Constitution: *The leading and guiding force of the Soviet society and the nucleus of its political system, of all state organisations and public organisations, is the Communist Party of the Soviet Union. The CPSU exists for the people and serves the people. The Communist Party, armed with Marxism-Leninism, determines the general perspectives of the development of society and the course of the home and foreign policy of the USSR, directs the great constructive work of the Soviet people, and imparts a planned, systematic and theoretically substantiated character to their struggle for the victory of communism. All party organisations shall function within the framework of the Constitution of the USSR.*

<sup>339</sup> "Mikhail S. Gorbachev Biography: Glasnost, Perestroika, and Leadership"; Editors of Encyclopædia Britannica, *Mikhail Gorbachev*

<sup>340</sup> M.S. Gorbachev, *Mikhael Gorbachev: Memoirs*, pp. 215

<sup>341</sup> G. Chiesa, *Time of Change: An Insider's View of Russia's Transformation*, p. 30; G.A. Hosking, *The Awakening of the Soviet Union*, p. 139

<sup>342</sup> Editors of Encyclopædia Britannica, *Mikhail Gorbachev*, 2017

<sup>343</sup> A. Brown, *The Gorbachev factor*, p. 141; J.F. Hough, *Democratization and Revolution in the U.S.S.R. 1985-1991*, pp. 124. Note however that alcohol tax was more lucrative than income tax at that time.

Change was also visible in the foreign affairs. To regain control on the army budget that phagocytized 12.5% of the GDP and stop the costly race with USA, Gorbachev adopted a novel strategy in the Cold War. He privileged a balance of military forces in the hope of maintaining alive (but separate) the two ideological systems. In his mind, this armed peace could induce a decrease in the tension that could potentially lead to a demilitarization of humanity and thus a better use of the limited financial resources of USSR. In the perspective of future negotiations on nuclear weapons with the West, Gorbachev unilaterally declared on 8 April 1985 that the deployment in Europe of SS-20 intermediate-range nuclear missiles was suspended. As a second step, in January 1986 he proposed the quick elimination of intermediate-range nuclear forces (INF) in Europe and at the beginning of the 21<sup>st</sup> century the potential destruction of the complete Soviet nuclear arsenal.<sup>344</sup>

In June 1985, at the 27<sup>th</sup> Congress of the CPSU, Gorbachev started to explain the general sketch of his new economic policy: *perestroika* (restructuring), some market-like reforms within command economy.<sup>345</sup>

To be consistent with his objectives and better concentrate the efforts on the internal reconstruction of the USSR, Gorbachev ordered on 28 July 1986 the gradual withdrawal of troops from Mongolia and from the unpopular as well as costly quagmire in Afghanistan.<sup>346</sup> And discussions with US president Reagan on 11 October 1986 at Höfði house in Reykjavík, Iceland, showed that the principle of (i) removing INF systems from Europe, (ii) limiting in both countries INF warheads to 100 and (iii) eliminating all nuclear weapons by 1996 (instead of 2000 as originally suggested by Gorbachev) was acceptable by both parties.<sup>347</sup>

In December 1986, started one of the main long-lasting internal issues of USSR: the unrest of the numerous nationalities and their respective determination to independence. The first spark, called *Jeltoqsan köterilisi* (December uprising in Kazakh), occurred between 16 and 19 December 1986 at Alma-Ata (now Almaty), Kazakhstan, when the First Secretary of the local Communist Party Dinmukhamed Kunayev was replaced by Gennady Kolbin, an outsider from the RSFSR. Even if the initiation of the riots remains debated, it later grew as a nationalistic protest.<sup>348</sup>

The General Secretary of the CPSU was fully aware of the tensions triggered by his (still limited) reforms. He notably considered a priority to replace the influence of the rigid *apparachiks*<sup>349</sup>, who preferred the Brezhnev era, by new personnel who supported his own policy. To do so, at the Central Committee Plenum in January 1987 he launched the slogan of *demokratizatsiya* (democratization). In the future, local and Soviets elections would include more than one candidate even though the Communist party would remain the only allowed one. To further stimulate the adhesion to his reforms, the General Secretary of the CPSU decided also to rehabilitate many opponents of Stalin.<sup>350</sup>

After securing his political influence, Gorbachev focused his energy on reducing the control on economy with 'radical reforms'.<sup>351</sup> During the month of June 1987 a new law gave more independence to enterprises and in November 1987 a book he authored detailed his ideas about *Perestroika*.<sup>352</sup>

<sup>344</sup> A. Brown, *The Gorbachev factor*, p. 227; D.T Jones and R. Bartek, *The Reagan-Gorbachev arms control breakthrough: the treaty eliminating Intermediate-Range Nuclear Force (INF) missiles*, pp. 20

<sup>345</sup> A. Brown, *op. cit.*, p. 146; M.S. Gorbachev, *On progress in implementing the decisions of the 27th CPSU Congress and the tasks of promoting perestroika : report by the General Secretary of the CPSU Central Committee to the 19th All-Union Party Conference, June 28, 1988*, pp. 1

<sup>346</sup> M.S. Gorbachev, *Mikhael Gorbachev: Memoirs*, 1996, pp. 401

<sup>347</sup> J.F. Jr. Matlock, *Reagan and Gorbachev: How the Cold War Ended*, 2004, pp. 20

<sup>348</sup> M.S. Gorbachev, *Mikhael Gorbachev: Memoirs*, 1996, p. 330; R. Sakwa, *Putin and the oligarch: the Khodorkovsky-Yukos affair*, p. 4

<sup>349</sup> *Apparachik* was a professional functionary of the Soviet Communist Party and/or government; later it was considered a privileged bureaucrat.

<sup>350</sup> A. Brown, *op. cit.*, p. 155; Editors of Encyclopædia Britannica, *Mikhail Gorbachev*, 2017

<sup>351</sup> *Ibid.*, p. 166

<sup>352</sup> M.S. Gorbachev, *Perestroika: New Thinking for Our Country and the World*, pp. 1

The problem of nationalities unexpectedly appeared in Russia under the shape of nationalism. In May 1987, 600 members of *Pamyat*, a nascent Russian nationalist group, who demonstrated in Moscow, received support from Boris Nikolayevich Yeltsin at that time First Secretary of the Moscow City Committee of the Communist Party, i.e. mayor of Moscow, and in parallel non-voting member of the Politburo.<sup>353</sup> Yeltsin was then blamed by the Politburo for not sanctioning the demonstrations. In response, Yeltsin took the decision to resign from these two positions. As this action had no precedence, Gorbachev (who had appointed at these positions Yeltsin<sup>354</sup>) asked to reconsider. To the astonishment of the audience of the plenary meeting of the Central Committee of the CPSU on 27 October 1987, Yeltsin renewed his request and explained that he reproved the slow pace of reforms as well as the servility shown to the General Secretary. Such attitude combined to the fact that Yeltsin was already popular for firing corrupted Moscow officials made him very popular (even though pressure from the Party and existing alcoholism led him to try to commit suicide).<sup>355</sup>

At the international level, under a proposition from Gorbachev on 22 July 1987, the INF Treaty is signed in Geneva on 24 November 1987.<sup>356</sup> Later, in February 1988, Gorbachev decided to stop the support of the Afghanistan Communist government and the concomitant complete withdrawal of Soviet army from Afghanistan, which became effective in 1989.<sup>357</sup> Furthermore, in 1988, Gorbachev denounced the Brezhnev Doctrine<sup>358</sup> and thus let the nations of the Eastern bloc freely manage their own internal affairs.<sup>359</sup>

Such *glasnost* (openness), including notably some freedom of speech, was also offered to the people and the press. In addition, many political prisoners and dissidents were released. This move associated USSR image to "Socialism with a human face". It also further pressured the conservatives who were more and more opposed to Gorbachev's policies.<sup>360</sup>

As done in 1987, this dose of freedom was combined with economic measures. Thus, in May 1988, the Law on Cooperatives allowed, for the first time since NEP, private ownership of enterprises in the fields of service (e.g. restaurants and shops), manufacturing (e.g. large industrial organizations) and foreign trade. Moreover, foreign investment was encouraged. Despite economic initiatives, public expenses grew at such a speed that gold funds decreased by ten folds. This situation led to limitations in availability of basic food supplies, e.g. flour, sugar, and thus in rationing. Later, the government realized that the high taxes and employment restrictions prevented attractiveness of the law and were thus abrogated.<sup>361</sup> Noteworthy, under the impulsion of the Law on Cooperatives the Commercial Innovation Bank for Scientific and Technical Progress was established in August 1988 and then chaired until 1990 by Mikhail Borisovich Khodorkovsky, the future CEO of OJSC Yukos Oil Company.<sup>362</sup>

<sup>353</sup> M.S. Gorbachev, *Mikhael Gorbachev: Memoirs*, pp. 348

<sup>354</sup> Yeltsin was appointed First Secretary of the Moscow City Committee of the Communist Party and non-voting member of the Politburo on 23 December 1985 and 18 February 1986 respectively.

<sup>355</sup> O. Conor, *Moscow 25 December 1991: The Last Day of the Soviet Union*, pp. 71 and 81; D. Pryce-Jones, *The Strange Death of the Soviet Empire*, pp. 86

<sup>356</sup> M.S. Gorbachev, *Mikhael Gorbachev: Memoirs*, pp. 439

<sup>357</sup> A. Brown, *op. cit.*, p. 235; Editors of Encyclopædia Britannica, *Mikhail Gorbachev*

<sup>358</sup> Doctrine according to Brezhnev's speech at the Fifth Congress of the Polish United Workers' Party on 13 November 1968: *When forces that are hostile to socialism try to turn the development of some socialist country towards capitalism, it becomes not only a problem of the country concerned, but a common problem and concern of all socialist countries.*

<sup>359</sup> A. Brown, *op. cit.*, p. 279

<sup>360</sup> M.S. Gorbachev, *Mikhael Gorbachev: Memoirs*, pp. 348; Gorbachev was inspired by Slovak Alexander Dubček (First Secretary of the Communist Party of Czechoslovakia from 5 January 1968 to 17 April 1969) and colleagues who agreed on the "Socialism with a human face" programme (i.e. some limited freedom and personal initiative in economics) at the Presidium of Communist Party of Czechoslovakia of April 1968 during the Prague Spring.

<sup>361</sup> A. Brown, *op. cit.*, p. 145; Editors of The Full Wiki, *Law on Cooperatives*

<sup>362</sup> R. Sakwa, *Putin and the oligarch: the Khodorkovsky-Yukos affair*, p. 5. The Commercial Innovation Bank for Scientific and Technical Progress was merged with other public/private organizations under the influence of Khodorkovsky to become on 29 December 1988 the Interbank Association for

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To further decrease the influence of conservatives and CPSU on his policy, Gorbachev initiated a presidential system in June 1988 at the Conference of the CPSU. The system also included the Congress of People's Deputies, a new legislative structure. Subsequently, between March and April 1989 the first multi-candidate elections (to the new Congress of People's Deputies) took place in USSR. There, Yeltsin, a popular member, continued to openly criticize the slowness of reforms. On his side, Gorbachev, as unique candidate, was elected Chairman of the Supreme Soviet, i.e. leader of USSR, on 25 May 1989.<sup>363</sup> *Glasnost* appeared to be fully applied as Gorbachev was elected with 59% of the Deputies' votes while existing elections in Soviet Union used to be closer to 100%.

On 16 November 1988, Estonia took advantage of the abandonment of the Brezhnev Doctrine to unilaterally declare its sovereignty. Then, the move grew in importance. Demonstrations in Tbilisi, Georgia, were contained on 9 April 1989. On its turn, in May 1989 Lithuania declared its sovereignty. On 4 June 1989, elections in Poland saw the loss of the Communist party. Also in June 1989, confrontations between two different nationalist groups of Uzbeks and Meskhetian Turks escalated in Fergana, Uzbekistan. Then, in July 1989 sovereignty was declared by the third Baltic country, Latvia. On 9 November 1989, the border in Berlin between East Germany (the German Democratic Republic, GDR) and West Germany (Federal Republic of Germany or FRG) was unexpectedly opened. In the end of 1989, the tragic Romanian revolution took place. In 1990 unrest continued in the sessionist SSR through the "war of laws", where SSR recognized only their own ruling.<sup>364</sup>

The appeal to change had been initiated and could now not be stopped. Multi-party elections were suggested at the February Central Committee Plenum and results from the local elections between February and March 1990 saw the large victory of pro-independence candidates. As a major change, Article 6 of the 1977 Soviet Constitution was amended to cancel the pre-eminence of the CPSU at the 3<sup>rd</sup> Extraordinary Congress of People's Deputies on 14 March 1990.<sup>365</sup> At that time, Lithuania went a step further in its no-confidence in Soviet authority; it declared independence and elected a national Chairman of the Supreme Council.<sup>366</sup>

To apply the novel principle of non pre-eminence of CPSU in USSR, the following supreme election on 15 March 1990 saw the nomination of Gorbachev as (first and last) President of the Soviet Union by the Congress of People's Deputies.

In October 1990, the 'war of laws' climaxed with the two main SSRs, i.e. Russia and Ukraine, refusing to acknowledge supremacy of Soviet laws over their own legal system. As a reaction, Gorbachev offered a new Union of Sovereign Soviet Republics in November 1990.<sup>367</sup> However, secessionism was the driving force in some SSRs. After trying force against Lithuania and Latvia in January 1991, Gorbachev eventually accepted the independence of the Baltic republics.<sup>368</sup> Such action was considered by Soviet conservatives as weakness while it was viewed by reformists (e.g. the President of RSFSR, Boris Yeltsin) as an incentive to accelerate the transition to a market economy. Consequently, Gorbachev's intermediate

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Scientific and Technological Development (named Menatep on 14 May 1990). The latter was the first private commercial bank in Russia with an initial capital of 200 millions rubles and some delegated authority from the state. Subsequently Menatep was the working horse of Khodorkovsky to notably take control of OJSC Yukos Oil Company.

<sup>363</sup> A. Brown, *op. cit.*, p. 202

<sup>364</sup> *Ibid.*, pp. 260-285. Note that for ending the Cold War Gorbachev was awarded the Otto Hahn Peace Medal in Gold in 1989 and the Nobel Peace Prize on 15 October 1990.

<sup>365</sup> The article 6 of the 1977 Soviet Constitution read as follows: *The Communist Party of the Soviet Union, other political parties as well as labor, youth and other public organisations and mass movements, through their representatives elected to the Councils of People's Deputies and in other forms participate in the policy-making of the Soviet state, in the management of state and public affairs.*

<sup>366</sup> M.S. Gorbachev, *Mikhael Gorbachev: Memoirs*, pp. 496

<sup>367</sup> *Ibid.*, pp. 496

<sup>368</sup> *Ibid.*, p. 279

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approach became extremely fragile; he lost most of his supporters.<sup>369</sup> A last illusion of unity survived with the approval by referendum of the Treaty on Union of Sovereign States (excluding however Armenia, Estonia, Georgia, Latvia, Lithuania and Moldova) in March 1991.<sup>370</sup> Conservatives, who remained powerful notably within the military and security forces, reacted against the treaty and prevented its signature by launching a coup d'état between 19 and 21 August 1991. Gorbachev was detained in his Crimean *dacha* while the Vice president Yanayev initiated a 'State Committee on the State of Emergency'. However, Boris Yeltsin who had been elected President of the Russian Federation on 12 June 1991 (following a referendum in Russia on the creation of the presidency in March 1991) prevented the success of the action. Gorbachev was free again but this time powerless.<sup>371</sup>

Within the Russian Federation, a swift move towards the financial support of the West had started. As a statement of RSFSR's independence, on 4 July 1991, the law "about foreign investments" was adopted.<sup>372</sup>

On 24 August 1991, Gorbachev resigned as General Secretary and the Supreme Soviet cancelled CPSU activities in USSR. Yeltsin, as President of the Russian Federation, further suspended all CPSU activities on Russian territory, took possession of the Kremlin and formalized the use of the Russian flag.<sup>373</sup> In Ukraine, independence was approved by referendum on 1 December 1991. Then the last steps of USSR occurred within a few days. On 8 December 1991, by signing the Belavezha Accords Presidents of Belarus, Russia and Ukraine acknowledged the replacement of Soviet Union by the Commonwealth of Independent States (CIS). On 12 December, the 1922 Union Treaty was rejected by RSFSR Supreme Soviet.<sup>374</sup> And on 21 December 1991, under the reluctant approval of Gorbachev, the Alma-Ata Protocol saw the formal creation of CIS and in anticipation the acknowledgement of the resignation of Gorbachev as President of USSR.<sup>375</sup> Such resignation, with the concrete end of Soviet Union, occurred on television on 25 December 1991.

## 2. Yeltsin Era (25 December 1991 - 31 December 1999)

Following the dissolution of the Soviet Union, on 2 January 1992, Yeltsin (Russian President and *de facto* his own Prime Minister) launched liberalization of currency, prices, capital flows and foreign trade. He embraced *perekhod*, a transition from Soviet administrative command planning to democratic free enterprise (the concept was similar to *perestroika* but added rejection of communism). Between the gradual transition and the shock therapy, Yeltsin chose the second option. Yeltsin accelerated the decriminalization of private property and promoted the principle of entrepreneurship while simultaneously he ordered to terminate compulsory state purchase. Enterprises were no longer required to follow Gosbank<sup>376</sup>

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<sup>369</sup> *Ibid.*, pp. 350

<sup>370</sup> *Ibid.*, p. 303

<sup>371</sup> *Ibid.*, pp. 290; M.S. Gorbachev, *Mikhael Gorbachev: Memoirs*, pp. 569

<sup>372</sup> Note that presidential edicts updated the law notably on 27 September 1993, 22 May 1994 and 25 January 1995. I. Krishtal and E. Lisovskaya, "Attraction of foreign capital, investment projects and mechanism of production sharing agreements", p.128; S. Marinich and R. Zafft, "Russia's new foreign investment law", pp. 435

<sup>373</sup> A. Brown, *op. cit.*, p. 305

<sup>374</sup> F.X. Clines, "Gorbachev is Ready to Resign as Post-Soviet Plan Advances"

<sup>375</sup> A. Brown, *op. cit.*, p. 304; M.S. Gorbachev, *Mikhael Gorbachev: Memoirs*, pp. 661; F.X. Clines, "11 Soviet States Form Commonwealth Without Clearly Defining Its Powers"

<sup>376</sup> As the Soviet State bank, Gosbank was a non-for-profit institution. It monitored inter-enterprise transitions and provided cash notably for wages. Its monopoly lasted from 1930s to 1987 where Gorbachev ordered the creation of specialized banks, e.g. *Agrobank* (USSR agricultural bank), *Promstoibank* (USSR bank of industrial construction), *Sberbank* (USSR savings bank) *Vneshekonombank* (USSR foreign trade bank) and *Zhilstroibank* (USSR bank of residential construction).

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supervision or to have *Gossnabsbyt*<sup>377</sup> manage their inputs and outputs.<sup>378</sup> "Transitologists" even proposed the *Programma "500 Dnei"* where 500 days would be sufficient to create a competitive market economy. It was anticipated that after a brief hyper-depression a swift and sustained rebound would bring a dynamic economy.<sup>379</sup>

Interestingly, on 21 February 1992, the federal Law on subsoil was established to define the mineral exploitation and licenses.<sup>380</sup> It was thus a unilateral administrative legal regime in favor of the licensor but the licensee became the owner of the allotted subsoil.<sup>381</sup> Knowing that regional governments were reluctant to give away power that USSR's collapse provided them, the law was based on dual federal/regional jurisdiction according to the 'two-key' principle of article 72 of the Russian Constitution.<sup>382</sup>

Following the loose monetary policy of the Central Bank of Russia in early 1992, the expected sharp increase in prices started. Living standards of the population steeply dropped and millions of citizens were plunged into poverty. Unemployment became a major concern. Moreover, a deep credit crunch occurred that led to the harsh shut down of many industries.<sup>383</sup> Through the 1990s, hyperinflation reached at some point more than 2,500% *per annum* and Russian GDP fell by 50%.<sup>384</sup>

To partly compensate the national hyperinflation and to try to maintain the support from the people, Yeltsin initiated in late 1992 a program to promote interest in privatization and in dividends within the population.<sup>385</sup> Such program consisted in distributing to all Russians free vouchers of a nominal value of around 10,000 rubles. The vouchers were meant to allow the people to purchase shares of a selection of state enterprises. However, a few well-informed intermediaries (who had connections to some banks and who later became oligarchs) diverted the initial principle.<sup>386</sup> They offered to buy the vouchers for immediate cash. Considering the fragile situation of most of Russians and their unexperience in financial investments, the intermediaries quickly collected large volumes of vouchers in exchange of little money. Therefore, they adventagously took control of valuable companies.<sup>387</sup>

Yeltsin quickly adopted an authoritarian attitude and often entered into conflict with the Supreme Soviet of Russia and the Congress of People's Deputies. On 20 March 1993 he stated that he was going to assume some "special powers" in order to secure the implementation of his reforms. The Congress of People's Deputies tried to impeach him via the swift organization of the 9th Congress of People's Deputies but the positive vote number did not reach the required two-thirds majority.<sup>388</sup>

Infuriated, on 21 September 1993, Yeltsin ordered an unconstitutional decree, the disband

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<sup>377</sup> The State Committee for Material-Technical Supply, within the State procurement system, was in charge of inter-enterprise supply and distribution of final goods to state retail outlets.

<sup>378</sup> S. Rosefielde, *op. cit.*, p. 165

<sup>379</sup> S. Shatalin *et al.*, *Transition to the market: 500 days*, pp. 1; J. Brada and A. King, "Is there a J-curve for economic transition from Socialism to capitalism?", pp. 37. Note that Gorbachev and the Supreme Soviet of the Soviet Union rejected the 500 Days Program in 1990 but adapted it as the more moderate "Basic Guidelines for Stabilization of the Economy and Transition to a Market Economy".

<sup>380</sup> Y. Adachi, "Subsoil law reform in Russia under the Putin administration", p. 1393

<sup>381</sup> *Ibid.*, p. 1399

<sup>382</sup> *Ibid.*, p. 1396

<sup>383</sup> P. Nolan, *China's Rise, Russia's Fall*, pp. 17

<sup>384</sup> S. Rosefielde, *op. cit.*, p. 225; D. Treisman, "Why Yeltsin Won: A Russian Tammany Hall"; T.P. Gerber and M. Hout, "More Shock than Therapy: Market Transition, Employment, and Income in Russia, 1991–1995", pp. 1

<sup>385</sup> Note that in December 1992 Chernomyrdin, the founder of OJSC Gazprom and deputy prime minister for the fuel and energy sector, became Prime Minister.

<sup>386</sup> Note that the number of private banks grew from 5 in 1989 to 2,500 in 1994. R. Sakwa, *Putin and the oligarch: the Khodorkovsky-Yukos affair*, p. 8

<sup>387</sup> T.J. Colton, *Yeltsin: A life*, pp. 263

<sup>388</sup> Editors of Encyclopædia Britannica, *Boris Yeltsin, president of Russia*

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of the Supreme Soviet and Congress of People's Deputies. Furthermore, he explained that he would rule by decree before the election of a new parliament and that he planned a referendum on a new constitution. Such move created a major political crisis. The Supreme Soviet considered that Yeltsin breached the constitution and Vice-President Alexander Rutskoy became the acting President.<sup>389</sup> However, in October 1993, Russian military and security forces supported Yeltsin and tanks surrounded Russia's parliament building.<sup>390</sup> In December 1993, the State Duma replaced the Russian Supreme Soviet but the majority, i.e. Communists and ultranationalists, was anti-Yeltsin. Remarquably, a parallel referendum approved the new Russian constitution that gave the President greater power, notably the right to appoint members of the government, dismiss the Prime Minister and in some occasions dissolve the State Duma. Thus Yelstin swiftly reacted and remained President.<sup>391</sup>

To divert pressure and show that the President wanted full control over the country, Yelstin sent troops to Chechnya in December 1994. After two years of violent fighting, a peace treaty was finally signed.<sup>392</sup>

In 1995, the Russian government adopted the Civil Code. Furthermore, based on this Code, it decided to define in December 1995 the PSA law<sup>393</sup> in order to structure the future flow of foreign investment that would develop the national energy operations. Specific taxation was defined according to profitability. However, as it protected licensees from taxes on cost overruns, it reduced pressure on production.<sup>394</sup> However, obligations of the licensee and the termination procedure were unclear.<sup>395</sup> Initially, while oil prices were low, three major foreign oil companies signed PSA: US ExxonMobil Corporation, Anglo-Dutch Royal Dutch Shell PLC and French Total SA. Such agreements modernized Russian facilities.<sup>396</sup> Most importantly, 60% of exploitation permits were awarded without any control. And, in other cases, contracts contained Soviet-style overly detailed obligations that made the license terminable at any time.<sup>397</sup>

The same year, Yeltsin was desperate to cover the growing foreign debt and budget deficit (being 10% of GDP).<sup>398</sup> Moreover, accumulated foreign investment totaled US\$6 billion while 10 fold more would have been appropriate to support the Russian economy.<sup>399</sup> His solution appeared to be a new wave of privatization (excluding foreign investors) in exchange for bank loans, the loan-for-shares scheme. To create attractiveness, he gave away stock shares of some of Russian most valuable state enterprises.<sup>400</sup> In return, oligarchs decided to remain loyal and supportive. Such privatization was well appreciated abroad. It gave the impression

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<sup>389</sup> T.J. Colton, *op. cit.*, pp. 293

<sup>390</sup> *Ibid.*, pp. 300

<sup>391</sup> The Constitution of the Russian Federation of 12 December 1993, Chapter 4. President of the Russian Federation, Section 1; D. Treisman, "Why Yeltsin Won: A Russian Tammany Hall"

<sup>392</sup> T.J. Colton, *op. cit.*, pp. 321

<sup>393</sup> PSA included (i) first a compensation of the capital investment and operating expenses by a part of the production and (ii) then a profit with royalties on the profit. V. Timokhov, "Recent development in the Russian Production Sharing Agreement law: Making the law work", p. 369; I. Krishtal and E. Lisovskaya, "Attraction of foreign capital, investment projects and mechanism of production sharing agreements", pp.128

<sup>394</sup> V. Timokhov, *op. cit.*, pp. 368; J.M. Waltrip, The Russian oil and gas industry after Yukos: Outlook for foreign investment, p. 577

<sup>395</sup> Y. Adachi, *op. cit.*, pp. 1394

<sup>396</sup> J. Evans, *Oil giants in legal row with Russia over joint projects*, 2006. Note that a few foreign (i.e. 1 Indian and 3 Japanese) minor companies were also involved.

<sup>397</sup> Obligations referred for example to the building of specific infrastructures for social institutions that had been *de facto* dissolved with the collapse of USSR. Y. Adachi, *op. cit.*, p. 1395

<sup>398</sup> R. Sakwa, *Putin and the oligarch: the Khodorkovsky-Yukos affair*, p.12

<sup>399</sup> I. Krishtal and E. Lisovskaya, "Attraction of foreign capital, investment projects and mechanism of production sharing agreements", p.128

<sup>400</sup> D. Allan, "Banks and the loan-for-shares auctions", pp. 137; P. Sutela, "Insider Privatization in Russia: Speculations on Systemic Changes", pp. 420



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that modernization of the economy was accelerated and that the government could again cover public expenses, such as officials' salaries and pensions. The International Monetary Fund (IMF) supported Yeltsin's policy by allowing a US\$10 billion loan to the Russian government.<sup>401</sup> Such actions were however partially sufficient to secure Yeltsin's reelection in 1996, as polls showed that the Communist party was supported by 35% of the population while Yeltsin only reached 4%. Oligarchs, notably Boris Abramovich Berezovsky<sup>402</sup>, sponsored an aggressive media campaign against a "return to totalitarianism" and Yeltsin succeeded to be reelected on 3 July 1996.<sup>403</sup> In the long run, this move strengthened the wealth and influence of the oligarchs within the global economy and Russian politics.<sup>404</sup>

Subsequently, health of Russia and Yeltsin were in similar conditions. In November 1996, the President underwent an emergency quintuple heart bypass surgery while the country was perfused by US\$40 billions from notably the IMF. Criticism mentioned that a part of the funds were diverted by members of Yeltsin's "family".<sup>405</sup>

At the beginning of 1998, the economic situation worsened. Governmental bonds offered too high interest rates to be reimbursed. Moreover, the oil price decreased to US\$10 per barrel, which led to a 25% drop in Russian government revenues. As the government defaulted on its debts on 17 August 1998, the ruble value steeply fell and companies in turn defaulted on foreign loans. The hyper-depressive free fall reached the bottom with this financial crisis.<sup>406</sup> It was the end of the oligarch golden age.

In 1999, the new Law on foreign investment further codified the 1995 PSA and tried to ensure equal rights between national and foreign investors. However, the wording was not unequivocal as the government retained 'broad delegation of regulatory power'.<sup>407</sup>

Then, in 1999, Yeltsin considered that Western countries did not respect anymore Russia and that the NATO pressured too much its zone of influence from the Baltic region to ex-Yugoslavia. During the Kosovo war, Yeltsin notably reminded the West that Russia remained a nuclear power.<sup>408</sup>

Noteworthy, on 9 August 1999, Yeltsin replaced his fourth Prime Minister, Sergei Stepashin, by Vladimir Putin, and considered him as his successor.<sup>409</sup>

On 15 May 1999, the democratic and communist opposition at the State Duma attempted again to launch a procedure of impeachment against Yeltsin<sup>410</sup> but the two-thirds majority was not reached.<sup>411</sup>

Finally, on 31 December 1999, Yeltsin transferred his presidential power to his Prime Minister Vladimir Putin and announced anticipated elections on 26 March 2000.<sup>412</sup>

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<sup>401</sup> T.J. Colton, *op. cit.*, pp. 330

<sup>402</sup> Berezovsky owned the country's main television channel, Channel One.

<sup>403</sup> D. Treisman, "Blaming Russia First"; B. Yeltsin, *Midnight diaries*, pp. 20

<sup>404</sup> Oligarchs included notably the so-called 'group of the seven bankers', i.e. Boris Berezovsky, Mikhail Fridman, Vladimir Gusinsky, Mikhail Khodorkovsky, Vladimir Potanin, Alexander Smolensky, Vladimir Vinogradov, and also Vagit Alekperov, Vladimir Bogdanov, Victor Vekselberg, Rem Viakhirev and a few years later Roman Abramovich.

<sup>405</sup> T.J. Colton, *op. cit.*, pp. 375

<sup>406</sup> S. Rosefielde, *op. cit.*, p. 163; Annex 8 - Russian GDP from 1989 to 2016 and crude oil price from 1861 to 2014

<sup>407</sup> S. Marinich and R. Zafft, "Russia's new foreign investment law", p. 440. Note that article 9 of this law guaranteed protection against 'unfavorable' changes in law, such as import custom duty rates, for the first seven years or as long as the profits did not cover investment.

<sup>408</sup> T.J. Colton, *op. cit.*, pp. 380

<sup>409</sup> *Ibid.*, pp. 407

<sup>410</sup> The diverse charges consisted of signing the Belavezha Accords, dissolving the Soviet Union in December 1991, launching a coup d'état in October 1993, and initiating the 1994 Chechnya war.

<sup>411</sup> T.J. Colton, *op. cit.*, pp. 410

<sup>412</sup> *Ibid.*, pp. 430

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### 3. The First Two Terms of the Putin Era (31 December 1999 - 7 May 2008)

On the very first day of his designation by Yeltsin, the acting President Putin had his first move to protect the former President and his relatives.<sup>413</sup> The Yeltsin era was hermetically close.

The Russian justice then started to investigate Putin's past during the 1990s when he was member of the Saint Petersburg city government or Russian government. However, all the charges against the suspect were dropped "for lack of evidence". Moreover, journalists or political opponents, such as Marina Yevgenyevna Salye, were silenced and on 12 February 2001, Putin updated his own protective decree of 1999.<sup>414</sup>

On 7 May 2000, Putin became the elected President and explained on 8 July 2000 his policy to bring justice.<sup>415</sup> As detailed in his meeting with business representatives on 28 July 2000, 'equidistance' has to be maintained between the state and business.<sup>416</sup>

In order to rebuild the strength and wealth of the country, between 2000 and 2004 Putin worked on bringing the oligarchs on his side and in parallel reduce the power of Russia's regional leaders. He expected the government to regain control on the Russian economy by having direct supervision on the major national companies. In exchange of the alignment with Putin's policy, the obscure methods of the oligarchs to acquire these entites in the 1990s would be forgotten.<sup>417</sup>

To stimulate investment and development, on 1 January 2002, tax reform strongly favored energy companies.<sup>418</sup>

In 2003, the violent second war of Chechnya was put to an end via a referendum that led to the creation of the Republic of Chechnya. The latter remained within the Russian Federation but acquired some autonomy with a parliament and a regional government.<sup>419</sup>

While the stabilization of Chechnya led to the full exploitation and distribution of Caucasian mineral resources, the schizophrenic indecision of the government between attracting foreign investors and controlling state subsoil stopped. As mineral prices increased, Putin privileged 'resource nationalism' and 'state capitalism'.<sup>420</sup> State power was regained through majority control over key Russian companies ('national champions' or according to Putin 'financial-industrial groups-corporations'<sup>421</sup>) and foreign shareholders limited to a minority.<sup>422</sup> In addition, on 1 January 2004, energy companies were exempted of local and regional taxes.<sup>423</sup>

As prestige and economy were restored (with GDP exceeding 1990s' levels), Putin was comfortably reelected as President on 14 March 2004.<sup>424</sup>

To regain control on subsoil and limit regional power, the two-key principle of the 1992 subsoil law was abolished via an amendment in 2004.<sup>425</sup> However, the law was not improved

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<sup>413</sup> The first presidential decree, entitled "On guarantees for former president of the Russian Federation and members of his family", guaranteed that "corruption charges against the outgoing President and his relatives" would not be pursued.

<sup>414</sup> K. Dawisha, *Putin's Kleptocracy: Who Owns Russia?*, pp. 104 and 163; C. Hutchins and A. Korobko, Putin, p. 81

<sup>415</sup> R. Sakwa, *Putin and the oligarch: the Khodorkovsky-Yukos affair*, p. 24

<sup>416</sup> *Ibid.*, pp. 24

<sup>417</sup> R. Sakwa, *Putin: Russia's Choice*, p. 143; A. Mommen, "Playing Russian Roulette: Putin in search of good governance", pp. 134

<sup>418</sup> J.M. Waltrip, *The Russian oil and gas industry after Yukos: Outlook for foreign investment*, pp. 594

<sup>419</sup> A. Roxburgh, *The strongman: Vladimir Putin and the struggle for Russia*, pp. 220

<sup>420</sup> P. Hanson, "Observation on the Costs of the Yukos Affair to Russia", p. 7; Y. Adachi, *op. cit.*, p. 1411

<sup>421</sup> H. Balzer, "Vladimir Putin's Academic Writings and Russian Natural Resource Policy", 2006, p. 51

<sup>422</sup> A. Aslund, "Russia's Energy Policy: A Framing Comment", 2006, pp. 3

<sup>423</sup> J.M. Waltrip, *op. cit.*, pp. 594

<sup>424</sup> A. Roxburgh, *The strongman: Vladimir Putin and the struggle for Russia*, 2012, pp. 108

<sup>425</sup> Y. Adachi, *op. cit.*, p. 1403

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despite many tentatives. The existing law remained unclear enough to let the 'big brother' rule impose itself.<sup>426</sup> Furthermore, to limit foreign participation, the state with the support of FSB worked on a new strategic sectors law (that was approved on 29 April 2008) and defined 'strategic fields' (also fully approved in 2008), according to a specific minimum volume of minerals, where auctions or tenders were limited to enterprises with Russian majority shares. Over the years and growing Putin's power, the minimum reserve size tended to gradually lower.<sup>427</sup>

The recovery of some wealth allowed the President to launch in 2005 the National Priority Projects in order to support key sectors such as agriculture, education, housing and the health care system.

In 2006, environmental clauses of the PSA were used to revoke the Royal Dutch Shell PLC contract and transfer it to state-controlled *Gazovaya Promyshlennost* (OJSC Gazprom). The ExxonMobil Corporation contract remained but related pipeline transport and exclusive purchase rights were taken control by OJSC Gazprom. Interestingly, the Total SA contract was apparently not so impacted because of special agreements between Total SA and Russian oil companies on one hand, and special relationships between French and Russian presidents at that time on the other hand.<sup>428</sup>

In January 2007, the government used Transneft, the pipeline-monopoly state company, to renegotiate with more favourable clauses the pipeline transport through Belarus. As oil-supply cut off impacted Eastern Europe, Belarus was pressured to quickly agree.<sup>429</sup>

In the following years, Putin maintained his authoritarian policy and found legal ways to remain in power.<sup>430</sup>

## B. Yukos History

The Russian reserves in oil and natural gas are respectively the eighth largest and the largest in the world. In the 2000s, more than 60% of the national export revenues depended on such sector.<sup>431</sup>

As a strategic Russian industry flagship in the field of natural resources, OJSC Yukos Oil Company<sup>432</sup> is a perfect example to illustrate the evolution of Russian policy. In the wild liberalized Russian economy of the post-Communism period, the company used all methods to prosper to a point where the government struck back. To detail such mechanism, the current part is divided in four sections: Promising creation (1993 - 1994); Wild hunter (1995); Search for respectability and power (1996 - 2003); Paying back envy and greed (2004).

### 1. Promising Creation (1993 - 1994)

In September 1991, the Ministry of Fuel and Energy was transformed into OJSC Rosneftgaz. On 17 November 1992, Yeltsin ordered by presidential decree No. 1403 that OJSC Rosneftgaz was renamed Rosneft and that its state owned structures and operations were divided into regionally concentrated private entities, i.e. 32 production structures and 29 refineries.<sup>433</sup> It was a first step towards privatization and consolidation of these strategic and

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<sup>426</sup> *Ibid.*, p. 1407. Note the quote from president of Lukoil company, Vagit Alekperov, when ceding majority control of a new Russian joint venture to OJSC Gazprom: "Gazprom is our big brother. The big brother must have 51%".

<sup>427</sup> *Ibid.*, p.1398, 1406, 1408 and 1410; J.M. Waltrip, *op. cit.*, pp. 598. Note that Lena goldfields area, now known as Sukhoi log, was classified as strategic subsoil. Moreover, the 'on gas supplies' law of November 2007 allowed state energy companies, such as OJSC Gazprom, to get access to gas deposits without any competition process.

<sup>428</sup> J.M. Waltrip, *op. cit.*, pp. 587 and 589

<sup>429</sup> *Ibid.*, pp. 600

<sup>430</sup> A. Roxburgh, *The strongman: Vladimir Putin and the struggle for Russia*, pp. 316

<sup>431</sup> Y. Adachi, *op. cit.*, p.1393

<sup>432</sup> Annex 9 - Logo of OJSC Yukos Oil Company

<sup>433</sup> T. Gustafson, *Wheel of fortune: The battle for oil and power in Russia*, 2012, pp. 98

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lucrative activities.<sup>434</sup> Consequently, on 15 April 1993 OJSC Yukos Oil Company<sup>435</sup> was created by resolution No. 354 of the Russian government through the merger<sup>436</sup> of:

- *Yuganskneftegaz* (Yugansk Oil and Gas), based in West Siberia (Tyumen Oblast) for oil extraction;
- *Kuybyshevnefteorgsintez* (Kuybyshev Oil and Organic Synthesis), located in Volga region (initially Kuybyshev and now Samara Oblast) with notably three refineries and eight oil-distribution networks.

On 12 May 1993, the company was officially established and became the second-largest producer in Russia with the largest local oil reserves.<sup>437</sup>

At that time, the former General Director of *Yuganskneftegaz*, Sergei Muravlenko<sup>438</sup>, was appointed first chairman and president of OJSC Yukos Oil Company.<sup>439</sup>

## 2. Wild Hunter (1995 - 1998)

On 8 December 1995, OJSC Yukos Oil Company was included in the loan-for-shares auction while the Menatep bank, managed by Mikhail Borisovich Khodorkovsky<sup>440</sup>, was responsible for processing the bids.<sup>441</sup> In a few successive days, Menatep gradually managed to control 78% of OJSC Yukos Oil Company's shares for an upfront payment of US\$350 million (a price slightly above the initial offer) and a three-year-long investment of US\$300 million.<sup>442</sup> The global price of OJSC Yukos Oil Company appeared to be limited to US\$450 million while Yukos market capitalization would reach US\$9 billion and US\$15 billion in 1997 and 2002 respectively. However, it appeared that the financial health of the company was poor mainly due to payment arrears of clients. It owed the employee salaries of the previous six months and US\$2 billion in tax arrears. Later, when the Russian government default on the loan, Menatep fully owned OJSC Yukos Oil Company.<sup>443</sup>

In 1996, Khodorkovsky, like the other oligarchs, supported Yeltsin's reelection. Such move fully opened the doors of the Kremlin in the following months. Menatep bank and OJSC Yukos Oil Company largely benefited from it.<sup>444</sup>

In 1998, with the crisis and the collection of pending taxes by the government, OJSC Yukos Oil Company decided to fire large numbers of employees. Considering that activities of the company were concentrated in a few cities, such places were hardly impacted.<sup>445</sup> Regarding the Menatep bank, the Moscow branch lost its banking licence due to 70% of its assets in state securities. The St Petersburg branch took over the full activity but foreign

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<sup>434</sup> Rosneft even became one of these entities, while the head management of this company/former ministry did not appreciate the loss of power.

<sup>435</sup> Note that Yukos is the following acronym: **Yuganskneftegaz** and **KuybyshevnefteOrgSintez**.

<sup>436</sup> Note that Samaraneftegaz (Samara Oil and Gas) refinery joined OJSC Yukos Oil Company in 1995 under decree No. 864.

<sup>437</sup> T. Gustafson, *Wheel of fortune: The battle for oil and power in Russia*, pp. 98

<sup>438</sup> Sergei Muravlenko was the son of Viktor Muravlenko, who had a prominent position in the oil and gas sector during the Soviet regime.

<sup>439</sup> R. Sakwa, *Putin and the oligarch: the Khodorkovsky-Yukos affair*, p. 12

<sup>440</sup> Khodorkovsky was deputy head of Komsomol (the Communist Youth League) at the Mendeleev University of Chemical Technology of Russia and graduated in chemical engineering in 1986. Then he started a business career at the *perestroika* period by using his connections within the communist structures. The Center for Scientific and Technical Creativity of the Youth that he co-opened turned into the Menatep bank, which allowed him to become an adviser of Yeltsin and subsequently an oligarch.

<sup>441</sup> Note that Menatep had prior financial relations with OJSC Yukos Oil Company in 1994.

<sup>442</sup> By autumn 1996, the Menatep bank controlled 90% of OJSC Yukos Oil Company.

<sup>443</sup> R. Sakwa, *Putin and the oligarch: the Khodorkovsky-Yukos affair*, pp. 15; L. Aron, *The Yukos Affair*

<sup>444</sup> S. Fortescue, *Russia's oil barons and metal magnates: Oligarchs and state in transition*, Palgrave Macmillan, Basingstoke, p. 59; D. Satter, *Darkness at dawn: the rise of the Russian criminal state*, p. 54

<sup>445</sup> P. Glatter, "Federalization, fragmentation, and the West Siberian oil and gas province", p. 156

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creditors were repaid by getting 29% of OJSC Yukos Oil Company's shares. To circumvent this stepback, OJSC Yukos Oil Company issued millions of shares, transferred abroad the real assets, left most shareholders with useless securities, let Khodorkovsky and associates repurchased the shares and finally transferred back assets to Russia.<sup>446</sup> Such methods created the sulphurous reputation of OJSC Yukos Oil Company.

### 3. Search for Respectability and Power (1999 - 2003)

Oil price increased again and in October 1999 Khodorkovsky planned large investment programme in order to build transparency, and made OJSC Yukos Oil Company adopt Western (accounting) standards. The company was already one of the world's leading producers but it wanted to attract foreign investors like most of the other major companies run by oligarchs. International overture was expected to bring legitimacy and most importantly independence from the Russian government. However, such move was not appreciated by the novel President. The latter started to pressure oligarchs to get back strategic companies. In October 1999<sup>447</sup>, vote of representatives of energy companies was forbidden in sessions of the Ministry of Fuel and Energy.<sup>448</sup> In 2000, only three out of the 'seven bankers' were still active while the media tycoon, Gusinsky, was attacked and later arrested with methods that anticipated the Khodorkovsky case by a few years. And tax affairs (with concrete or alleged evidences) impacted most large Russian companies.<sup>449</sup> Khodorkovsky on the contrary felt strong enough to start to challenge the power of Putin, who on his side considered an attack against him as a direct attack against Russia.

In 2001, OJSC Yukos Oil Company had started its seduction operation before the public opinion by providing one third of the Russian charitable donations. As a contingency plan, the government created taxes on donations in January 2002 but Khodorkovsky created foundations abroad.<sup>450</sup>

In early 2002, Khodorkovsky went a step further by offering 25% of OJSC Yukos Oil Company to British Petroleum PLC (BP) to get international expertise and avoid Russian governmental control.<sup>451</sup>

In late 2002, a working group headed by Yury Yevgenyevich Zaostrovtshev, FSB deputy director (and head of the FSB economic security department, and businessman), studied the structure of OJSC Yukos Oil Company.<sup>452</sup>

In 2003, Khodorkovsky increased his lobbying and financial support of opposing parties to the Russian government in the perspective of the parliamentary election on 7 December 2003. He also suggested political reforms. By doing so and publicly acknowledging it on 7 April 2003, Khodorkovsky had crossed the red line predefined by Putin.<sup>453</sup>

On 19 February 2003, at the fifth meeting of business leaders with Putin in the Kremlin, Khodorkovsky criticized corruption in Russia and subsequently was asked to leave the country.<sup>454</sup>

On 14 May 2003, OJSC Yukos Oil Company signed with OJSC Sibneft<sup>455</sup> a merger contract to create the fourth largest private company in the world. Such move was initially accepted by the government as it was similar to a parallel deal between OJSC *Tyumenskaya Neftyanaya Kompaniya* (Tyumen Oil Company, TNK) and BP. However, Khodorkovsky later

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<sup>446</sup> R. Sakwa, *Putin and the oligarch: the Khodorkovsky-Yukos affair*, p. 17; P. Klebnikov, "The oligarch who came in from the cold"

<sup>447</sup> While Putin was still Prime Minister for a few remaining days.

<sup>448</sup> R. Sakwa, *Putin and the oligarch: the Khodorkovsky-Yukos affair*, p. 26

<sup>449</sup> *Ibid.*, 2014, pp. 19 and 27

<sup>450</sup> *Ibid.*, p. 39

<sup>451</sup> *Ibid.*, p. 52

<sup>452</sup> *Ibid.*, p. 74

<sup>453</sup> *Ibid.*, p. 63

<sup>454</sup> *Ibid.*, pp. 54. Khodorkovsky notably cited independent reports where it was stated that 72% of Russians feared courts as bribes were too elevated.

<sup>455</sup> OJSC Sibneft is now Gazprom Neft, a subsidiary of OJSC Gazprom.

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suggested that 25-40% of shares was to be sold to an American oil company. Knowing that Yukos' Chief financial officer (CFO), Bruce Misamore, was American, Putin considered that the potential share transfer to a US entity was a national treason and the merger with OJSC Sibneft was subsequently cancelled.<sup>456</sup> On 16 May 2003, Putin declared that he planned to double Russian GDP in ten years.<sup>457</sup> To reach such ambitious objective, he based his projections on the full support of the companies in the energy field. Therefore, Khodorkovsky's international vision with OJSC Yukos Oil Company was going against presidential views. Strategic subsoil could not be controlled from abroad.

#### 4. Paying Back Envy and Greed

Year 2003 saw a governmental turn from liberalism to statism. Economy had to be controlled and an example made to illustrate the new rules. The attack was conducted in parallel against Khodorkovsky and OJSC Yukos Oil Company.<sup>458</sup>

First, it was suggested at the Duma that the 20% control of OJSC Yukos Oil Company on JSC Apatit<sup>459</sup> was illicit. Then, on 19 June 2003, the head of the economic security service at OJSC Yukos Oil Company (and former KGB officer) was charged of organizing three murders and two attempts. The number of arrests increased in the head management of OJSC Yukos Oil Company and fraud investigations intensified. Authorities claimed that the company had large tax arrears while OJSC Yukos Oil Company used his US GAAP accountancy to prove the opposite. Moreover, the reduced tax rate of 11% (compared to the regular rate of 30%) was applied to all similar companies but only OJSC Yukos Oil Company was charged.<sup>460</sup>

Khodorkovsky toured in Russia and abroad to pressure Putin but the effect was limited. Some US politicians, such as Vice-President Richard Bruce "Dick" Cheney, brought some support to Khodorkovsky while others, such as Condoleezza "Condi" Rice, considered Khodorkovsky as a distraction from the required unity against al-Qaeda terrorism.<sup>461</sup>

On 25 October 2003, Khodorkovsky was arrested by FSB forces, as he did not immediately present himself before the prosecutor general's office. Such measures were disproportionate compared to the charges of fraud and tax evasion. Then, Khodorkovsky was maintained in pre-trial detention.<sup>462</sup> Khodorkovsky adopted an aggressive defense strategy during his trials but in the end was jailed for ten years. After Putin's pardon, he was granted residency in Switzerland.<sup>463</sup>

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<sup>456</sup> R. Sakwa, *Putin and the oligarch: the Khodorkovsky-Yukos affair*, pp. 57 and 79. Note that a first attempt of merger occurred in 1998 but a dispute within the management team prevented it.

<sup>457</sup> *Ibid.*, p. 34

<sup>458</sup> *Ibid.*, pp. 72

<sup>459</sup> A Russian company specialized in the extraction of minerals for manufacturing chemicals and fertilizers.

<sup>460</sup> R. Sakwa, *Putin and the oligarch: the Khodorkovsky-Yukos affair*, pp. 75

<sup>461</sup> *Ibid.*, pp. 80

<sup>462</sup> *Ibid.*, pp. 82 and 92

<sup>463</sup> *Ibid.*, pp. 138 and 202. To make a comparison with additional oligarchs, note that alliance with the Russian government proved more successful than opposition: Boris Berezovsky (he became a political opponent and subsequently exiled in England where his death on 23 March 2013 was considered suspicious after two alleged FSB plots in 2003 and 2007; he lost his claim on OJSC Sibneft ownership before a London High Court in 2012), Mikhail Fridman (while successful in business, he sold his stake in TNK-BP to Rosneft in 2013), Vladimir Gusinsky (following opposition to Putin, he was detained and was pressured with legal cases even when in exile), Vladimir Potanin (he has limited his activities to business), Alexander Smolensky (after bankruptcy of his bank and the drop of money laundering charges in 1998, he limited his activities to newspaper business), Vladimir Vinogradov (after unwise political statements and bankruptcy of his bank in 2000, he limited his activities to business until his death in 2008), Vagit Alekperov (he became president of OJSC LUKoil Oil Company in 1993; he has being a supporter of Putin), Vladimir Bogdanov (he became president of OJSC Surgutneftegaz Oil Company in 1993; he has being supportive of Putin), Victor Vekselberg (president of the Renova Group in aluminum and oil sectors, notably through TNK; he has being supportive of Putin), Rem Viakhirev (From 1992 until 2001, he was notably the Gazprom

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Some assets of OJSC Yukos Oil Company were frozen and in April 2004 the \$27 billion tax claims that exceeded the combined revenues of the company for 2002 and 2003, were requested as a single payment. In July 2004, *Yuganskneftegaz*, which value ranged the claims, was confiscated. However, in December 2004, a closed-room auction was decided. No foreign company dared to compete and one out of the two declared Russian bidders, Gazpromneft (a subsidiary of OJSC Gazprom), preferred to leave due to US legal issues. Thus *Yuganskneftegaz* was sold for only USD\$9.35 billion to an obscure company *Baikalfinansgrup* (Baikal Finance Group), which later appeared to be created just for the legal circumstances of this deal by OJSC Rosneft, a pro-Putin state-owned oil company. As a second step, OJSC Rosneft acquired *Baikalfinansgrup* and tax claims disappeared. Bankruptcy and liquidation of OJSC Yukos Oil Company occurred respectively in 2006 and 2007.<sup>464</sup>

Interestingly, in November 2006, after three years of activity, TNK-BP was charged of violations of environmental and licensing rules. It was threatened to not compete with the quasi-monopolistic position of OJSC Gazprom in Eastern Siberia. In June 2007, TNK-BP sold majority control of one of its main Russian oil fields.<sup>465</sup>

### C. Overview of Yukos Cases

In reaction to the prompt OJSC Yukos Oil Company's stripped away by Russian authorities, the top management and shareholders decided to call for legal actions and publicized them. As foreign assets of the company had survived the Russian raid and as some head staff was of foreign origins, they considered that existed some ground to get compensation abroad against what appeared as a political unlawful expropriation. Note that political pressure had to be intense as in countries dependent on Russia, such as Armenia, the subsidiary Yukos CIS was initially not to be transferred to OJSC Rosneft but in the end local courts reversed the order.<sup>466</sup>

On the other hand, it has to be reminded that the complex financial structure of OJSC Yukos Oil Company was viewed by some as a sophisticated example of investment round-tripping. Domestic investors (controlling roughly 70% of the enterprise in the case of OJSC Yukos Oil Company) used foreign holding companies and trusts in more protective jurisdictions, notably in fiscal paradises, to invest in their home country and run local private institutions under more favorable conditions.<sup>467</sup>

Here, different cases are analysed according to the different types of jurisdictions or claimants: Some cases in non-Russian national courts; Arbitration case of Yukos Capital Sarl; Yukos case before the European Court of Human Rights; Arbitration cases of majority shareholders; Arbitration cases of minority shareholders.

#### 1. Some Cases in Non-Russian National Courts

a) As the CFO of OJSC Yukos Oil Company was American, the company was allowed in December 2004 to file for voluntary bankruptcy in Houston. Such approach led Gazprom and Deutsche Bank to not participate in the auction of *Yuganskneftegaz* but OJSC Rosneft circumvented the restriction by using a Trojan horse to win the bid. Noteworthy, the order of the Houston court was temporary and some months later the court considered that globally the

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CEO; he supported Putin until his death on 11 February 2013) and Roman Abramovich (he created a conglomerate including notably a partial control over OJSC Sibneft. He was the first person to recommend Putin to Yeltsin as his presidential successor).

<sup>464</sup> M. Sixsmith, *Putin's oil: the Yukos affair and the struggle for Russia*, pp. 230

<sup>465</sup> J.M. Waltrip, *op. cit.*, pp. 589

<sup>466</sup> P.B. Stephan, "Taxation and expropriation - The destruction of the Yukos oil empire", p. 34

<sup>467</sup> D. Nougayrede, "Yukos, investment round-tripping, and the evolving public/private paradigms", pp. 338

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link to USA was too weak.<sup>468</sup> This tentative was a legal failure but appeared to be beneficial to the international exposure of the case.

b) Civil suits were initiated by shareholders in USA against theft of OJSC Yukos Oil Company's assets via alleged violations of US federal, US state, and Russian law. However, courts judged that they lacked jurisdiction as either defendants were not connected to USA or were protected by foreign sovereign immunity.<sup>469</sup>

c) In a furious attempt to eradicate OJSC Yukos Oil Company, the Russian government tried to extradite people related to Yukos who took refuge notably in UK, Cyprus and Lithuania. However, all local courts considered evidences as deficient.<sup>470</sup> For identical reasons, Swiss and Liechtenstein authorities refused to seize records of companies that collaborated with OJSC Yukos Oil Company.<sup>471</sup>

## 2. Arbitration Case of Yukos Capital Sarl

To settle debts of OJSC Yukos Oil Company in 2004, the Russian administrator tried to sell to OJSC Rosneft notably the subsidiary Yukos Finance BV in the Netherlands. However, the Russian bankruptcy proceeding was not acknowledged by a Dutch court and the latter even allowed the offshore subsidiary to transfer most of its assets to Dutch stichtings<sup>472</sup>, i.e. local protective trust, indirectly controlled by Yukos's former management and shareholders. The Luxembourg-based Yukos Capital Sarl, of interest in the present section, was included in the Dutch stichtings.<sup>473</sup>

On the basis of a loan agreement that *Yuganskneftegaz* had defaulted, Yukos Capital Sarl managed to obtain in 2006 an award of US\$ 245 million from the Chamber's International Commercial Court (ICC) via the Russian Chamber of Commerce. As OJSC Rosneft had acquired *Yuganskneftegaz* by that time, it became directly involved in the case and decided to go before the *arbitrazh* court, i.e. Russian arbitration court. In 2007, the ICC awards were annulled.

Notwithstanding the annulment, Yukos Capital Sarl decided, as a strategic move, to request the enforcement of the ICC awards in the Netherlands. While the first-instance Dutch court ruled against Yukos Capital Sarl, the Amsterdam Court of Appeal regarded the Russian *arbitrazh* courts as partial and not independent, which led to the use of the private international law as well as the Dutch public order, and thus the enforcement of the award in 2009.<sup>474</sup> As

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<sup>468</sup> In re Yukos Oil Co., 320 Bankruptcy Reporter 130, 132 (United States District Court for the Southern District of Texas 2004); In re Yukos Oil Co., 321 Bankruptcy Reporter 396 (United States District Court for the Southern District of Texas 2005)

<sup>469</sup> Allen v. Russian Federation, 522 Federal Supplement, Second Series 167, 171 (The United States District Court for the District of Columbia 2007); In re Application of Yukos Hydrocarbons Investments Ltd., 2009 Westlaw 5216951 (The United States District Court for the Northern District of New York); In re Application of OOO Promneftstroy, 2009 Westlaw 3335608 (The United States District Court for the Southern District of New York); In re Yukos Oil Co. Securities Litigation, Federal Securities Law Reporter paragraph 94,115 (The United States District Court for the Southern District of New York 2006)

<sup>470</sup> Government of the Russian Federation v. Maruev and Chernysheva, Bow Street Magistrate Court, 23 December 2005; Government of the Russian Federation v. Temerko, Bow Street Magistrate Court, 18 March 2005; Application No. 2/07 of the Law on extraction of fugitives 95/70, District Court of Nicosia, 10 April 2008; Editors of Sputnik, "Lithuania's Supreme Administrative Court upheld Monday political asylum for a former Yukos banker wanted in Russia on embezzlement charges", 16 October 2006

<sup>471</sup> P.B. Stephan, "Taxation and expropriation - The destruction of the Yukos oil empire", 2012, pp. 28

<sup>472</sup> Stichting Administratiekantoor Yukos International and Stichting Administratiekantoor Financial Performance Holdings. Note that a Dutch stichting is a local protective foundation with no members. More specifically, it is a legal entity with limited liability and separate functions of ownership and control. Its statutes can include only payments to charitable causes.

<sup>473</sup> P.B. Stephan, *op. cit.*, p. 34

<sup>474</sup> Yukos Capital SARL v. OAO Rosneft, Case No. 200.005.269/01, Amsterdam Court decision, 28 April 2009



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OJSC Rosneft agreed to pay, the case became the first success of the former Yukos' shareholders and for the first time the recognition by a non-Russian court of the lawless tax procedure against Yukos.<sup>475</sup>

Moreover, this decision continued to impact the international development of OJSC Rosneft. Indeed, Yukos Capital *Sarl* decided to sue OJSC Rosneft in London for the unpaid US\$ 160 million postaward interest. The place was pertinent as OJSC Rosneft had planned since 2006 to list its shares on the London Stock Exchange and to publicly sale a limited number of them (Initial public offering). During the trial, OJSC Rosneft invoked (i) the Russian judicial annulment, (ii) the fact that the issue related to the loan agreement was illegal and a diversion from the Yukos' tax fraud and finally (iii) the act of state doctrine of the UK Financial Services Authority (FSA)<sup>476</sup>. In 2011, the England and Wales High Court of Justice (more specifically the Commercial Court) relied on the Dutch courts' decision, which estopped OJSC Rosneft from invoking the Russian judicial annulment. Additionally, the High Court ruled that the FSA's act of state doctrine did not apply.<sup>477</sup> Subsequently, in 2012, the England and Wales Court of Appeal (more specifically the Civil Division) validated the previous decision about the act of state doctrine, as doctrine applied to governmental or parliamentary acts, but not to judicial ones. However, the Court of Appeal did not uphold the High Court on the estoppel, considering that local standards did not necessarily need to follow all Dutch ones. Consequently, Yukos Capital *Sarl* could use any evidence against OJSC Rosneft while the latter could mention the Russian decision.<sup>478</sup>

More recently in 2014, the England and Wales High Court of Justice (more specifically the Commercial Court) confirmed that it was not bound to apply a ruling from a foreign court that set aside an award if that decision offended domestic public policy and basic principles of natural justice.<sup>479</sup>

On 1 April 2015, a representative for former Yukos shareholders publicly declared that the day before a confidential non-financial settlement was reached with OJSC Rosneft and applied to all jurisdictions.<sup>480</sup> It notably provided certainty of ownership of Dutch stichting indirectly controlled by the ex-Yukos management. However, the settlement did not cover the ECtHR judgment and the majority shareholders judgments (see below).<sup>481</sup> Thus according to Dutch law, the Yukos shareholders could foresee some financial return as no litigation should exist to make payments from stichtings to owners.

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<sup>475</sup> P.B. Stephan, *op. cit.*, pp. 37

<sup>476</sup> Previously, Yukos had tried to prevent the listing Rosneft's shares on the London Stock Exchange by alleging that such action was the laundering of proceeds of a crime and thus violating British law. However, the local High Court had carefully ruled that (i) FSA had the discretion to interpret the state doctrine and that (ii) FSA was not required to determine the innocence or guilt of Rosneft according to international law, in particular the European Convention on Human Rights.

<sup>477</sup> Yukos Capital S.a.r.L. v. OJSC Rosneft Oil Company, 2011, England and Wales High Court of Justice (Commercial court) decision 1461

<sup>478</sup> Yukos Capital S.a.r.L. v. OJSC Rosneft Oil Company, 2012, England and Wales Court of Appeal (Civil Division) decision 855

<sup>479</sup> Yukos Capital SARL v OJSC Rosneft Oil Company, 2014, England and Wales High Court of Justice (Commercial court) decision 1288

<sup>480</sup> The settlement took place between Rosneft and a group of its subsidiaries including Samaraneftgaz, Tomskneft and Angarsk Petrochemical Company on one hand, and Yukos Finance BV, Yukos Capital *sarl*, Stichting Administratiekantoor Yukos International, Stichting Administratiekantoor Financial Performance Holdings, Consolidated Nile LP, General Nile LLC, Yukos International (UK) BV, Luxtona Limited, Financial Performance Holdings BV, Yukos Hydrocarbons Investments Limited, CN & GN (PTC) Ltd on the other hand.

<sup>481</sup> Editors of Reuters, *UPDATE 2-Russia's Rosneft, Yukos settle legal disputes*, 1 April 2015

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### 3. Yukos Case Before the European Court of Human Rights<sup>482</sup>

On 23 April 2004, OJSC Yukos Oil Company sued the Russian Federation before the European Court of Human Rights (ECtHR), claiming that (i) the bankruptcy and liquidation procedure in Russia was discrimination compared to similar enterprises and that (ii) Russian courts had violated its rights during that procedure.<sup>483</sup>

As a strategic approach, the claimant was the company by itself. Indeed, previous cases before the ECtHR had showed that shareholders even being the majority were disregarded, as they failed to represent the company's legal personality.<sup>484</sup>

In its 2009 ruling, the ECtHR admitted the claims<sup>485</sup> despite the liquidation of the claimant. Indeed, the court viewed the case as (i) an issue that 'transcends the interests of the applicant company' and (ii) a way to grant 'the right of individual applications by legal persons', otherwise 'it would encourage governments to deprive such entities of the possibility to pursue an application lodged at a time when they enjoyed legal personality'.<sup>486</sup>

Later, in 2011, the ECtHR had to evaluate the potential infringement of the principle of litispendence or 'parallel litigation', as the cases of the majority shareholders (see below) were treated in parallel.<sup>487</sup> According to Article 35(2)(2) of the Convention<sup>488</sup>, the ECtHR considered the current case through 'a comparison of the parties in the respective proceedings, the relevant legal provisions relied on by them, the scope of their claims and the types of the redress sought'.<sup>489</sup> Taken together, the Court concluded that parties were different.<sup>490</sup>

The court studied breaches of Article 6 of ECHR and Article 1 in the Additional Protocol 1.

Regarding the breach of Article 6 on the rights to a fair hearing of ECHR, ECtHR had a restricted view. It agreed that Yukos did not have sufficient time to study the case file and

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<sup>482</sup> Note that the discussed case differs from the following one: *Khodorkovskiy and Lebedev v Russia* App 11082/06 and 13772/05 (ECtHR, 25 July 2013)

<sup>483</sup> Claims were based on violations (alone and in conjunction) of Article 1 (obligation to respect human rights), Article 6 (right to a fair trial), Article 13 (right to an effective remedy), Article 14 (prohibition of discrimination), Article 18 of the ECHR (limitation on the use of restrictions on rights) and Article 1 of Protocol 1 to the Convention (right to property). E. De Brabandere, "Case comment: Yukos Universal Limited (Isle of Man) v The Russian Federation - Complementarity or Conflict? Contrasting the Yukos Case before the European Court of Human Rights and Investment Tribunals", pp. 348

<sup>484</sup> "The piercing of the 'corporate veil' or the disregarding of a company's legal personality will be justified only in exceptional circumstances, in particular where it is clearly established that it is impossible for the company to apply to the Convention institutions through the organs set up under its articles of incorporation or—in the event of liquidation—through its liquidators." From *Agrotexim and Others v Greece* App 14807/89 (ECtHR, 24 October 1995) paragraph 66, citing the International Court of Justice's decision in *Barcelona Traction, Light and Power Company Limited (Belgium v Spain)* (Judgment) [1970] ICJ Rep 39 and 41, paragraphs 56-8, 66. Opposing example where 'majority or controlling interest' was accepted as a claimant: *Yarrow and Others v the United Kingdom* App 9266/81 (ECtHR, 28 January 1983) 185.

<sup>485</sup> The ECtHR only declared manifestly ill-founded a part of the alleged infringements of Article 6 (right to a fair trial) of the Convention for the Protection of Human Rights and Fundamental Freedoms.

<sup>486</sup> Case of *OA O Neftyanaya Kompaniya Yukos v Russia* App 14902/04 (ECtHR, 29 January 2009), paragraphs 439-44

<sup>487</sup> C. McLachlan, *Lis Pendens in International Litigation*, Martinus Nijhoff Publishers, Leiden 2009, p. 43

<sup>488</sup> Article 35(2)(2) reads as follows: "The Court shall not deal with any application submitted under Article 34 that: is substantially the same as a matter that has already been examined by the Court or has already been submitted to another procedure of international investigation or settlement and contains no relevant new information."

<sup>489</sup> *OA O Neftyanaya Kompaniya Yukos v Russia* App no 14902/04, Judgment (ECtHR, 20 September 2011), paragraph 521

<sup>490</sup> *OA O Neftyanaya Kompaniya Yukos v Russia* App no 14902/04, Judgment (ECtHR, 20 September 2011), paragraph 524

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prepare for the appeal hearings. However, the Court did not consider the Russian action against Yukos to be arbitrary or unfair.<sup>491</sup>

For the right to property, the ECtHR evaluated the Russian tax reassessment proceedings according to the following points:<sup>492</sup>

- The Russian Constitutional Court had ruled a retroactive application of the tax statutory time limit that induced a repeat offence of the year 2001 tax and thus the doubling of the penalties due by OJSC Yukos Oil Company;
- Focus on the seizure and auction of Yuganskneftegaz, and the obligation to pay a full 7% enforcement fee.

In this context, the court relied on the existing understanding<sup>493</sup> of Article 1 of Protocol 1<sup>494</sup>, i.e. the right to property is not explicit but it is guaranteed while the authorization of lawful expropriation is allowed under certain conditions. Globally, the Russian enforcement measures were found lawful 'on account of the alleged disguised expropriation of the company's property and the alleged intentional destruction of the company itself' but not proportional to the legitimate aim pursued.<sup>495</sup> Interestingly, the court ruled that no expropriation occurred as no evidence was provided. Indeed, the claimant stated that the intention of the Russian government and its political motivation were 'the least of the concerns'. Thus, the claimant limited its approach on the disproportion of the enforcement procedures.<sup>496</sup>

On 21 December 2011, the claimant tried to appeal on the ground that the various processes leading to the company's bankruptcy had not been politically motivated. However, on 8 March 2012, the ECHR ruled against revising the case.

Subsequently the financial reparation was quantified. The claimant considered that the reparation should cover the company's value on 19 December 2004 and include a compensation of the penalties for the years 2000 and 2001 with the 7% enforcement fee in respect of these penalties, which globally amounted to € 37.981 billion. The court disagreed, as 'the prospects of the applicant company's survival and its value in the aftermath of the events remain at least in part speculative'. Consequently, on 31 July 2014 ECtHR ordered in its judgment on just satisfaction<sup>497</sup> a payment to the claimant of € 1,866,104,634 as compensation for the material losses sustained by Yukos shareholders, as registered at the time of the company's liquidation, or to any successors or heirs.<sup>498</sup> Noteworthy, the court ruled that the 7% enforcement fee was 'disproportionate' and preferred a 'proportional' 4% in view of

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<sup>491</sup> OAO Neftyanaya Kompaniya Yukos v Russia App no 14902/04, Judgment (ECtHR, 20 September 2011), paragraph 551

<sup>492</sup> De Brabandere, "Case comment: Yukos Universal Limited (Isle of Man) v The Russian Federation - Complementarity or Conflict? Contrasting the Yukos Case before the European Court of Human Rights and Investment Tribunals", p. 350

<sup>493</sup> Marckx v Belgium App 6833/74 (ECtHR, 13 June 1979), paragraph 63; Spörring and Lönnroth v Sweden App 7151/75 and 7152/75 (ECtHR, 23 September 1982), paragraph 60

<sup>494</sup> Article 1 (right to property) of Protocol 1 to the ECHR reads as follows: "*Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.*

*The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.*"

<sup>495</sup> De Brabandere, *op. cit.*, pp. 349

<sup>496</sup> *Ibid.*, pp. 350

<sup>497</sup> OAO Neftyanaya Kompaniya Yukos v Russia App no 14902/04, Judgment (Just Satisfaction) (ECtHR, 31 July 2014)

<sup>498</sup> A. Newcombe, "Case comment: Yukos Universal Limited (Isle of Man) v The Russian Federation - An Introduction to the Agora", p. 291

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the high amount of the reparation.<sup>499</sup> Moreover, Russia was found liable for € 300,000 to cover court expenses.<sup>500</sup>

As the Russian Federation was dissatisfied, it contested the compensation decision. In December 2014, Russia's appeal to the Grand Chamber was rejected.<sup>501</sup> On 14 July 2015, the Russian constitutional court made a general statement that the ECtHR judgments did "not override the pre-eminence of the constitution in the Russian legal system".<sup>502</sup> Subsequently, under the request of the Russian Ministry of Justice, the Russian Constitutional Court evaluated the ECtHR decision and ruled on 19 January 2017 that it was 'impossible in accordance with the Russian Constitution'. The chairman of the Russian Constitutional Court declared that 'Russia has the right, on the basis of goodwill, to make certain payments to the former shareholders of the company affected by the illegal actions of its management, through Yukos' unveiled property' but the payments 'should not affect the costs and revenues of the Russian budget and Russian property'.<sup>503</sup>

#### 4. Arbitration Cases of Majority Shareholders

In 1997, the control over OJSC Yukos Oil Company was made more complex through at least three layers of international intermediary structures. OJSC Yukos Oil Company was held at the first level by two Cyprus holding companies, then at the second level by entities from the Isle of Man and Jersey, and at the third level directly or indirectly by the Gibraltar company GML Ltd, i.e. the former Group Menatep. At this point, GML Ltd owned 60 percent of OJSC Yukos Oil Company. Noteworthy, in such system, a tax treaty existed between Russia and Cyprus<sup>504</sup> while the other locations were overseas dependencies of UK and thus protected by the Energy Charter Treaty (ECT)<sup>505</sup>. Subsequently, at the fourth level, the supervision had been shared since 2003 by seven companies from British Virgin Islands owned by seven Guernsey trusts. Thus the Yukos shares controlled by GML shares were settled into the above-mentioned trusts.<sup>506</sup> The Yukos shareholder retained control according to offshore trust law via their "protectors" position. Such position obliged the trustee to get the consent of the protector (through "letters of wishes") for important decisions. Additionally, the trust assets were beyond the reach of creditors.<sup>507</sup>

After a formal notification to the Russian government on 2 November 2004, the GML Ltd-controlled entities<sup>508</sup> filed on 3 and 14 February 2005 lawsuits before the tribunal at the Permanent Court of Arbitration in The Hague (PCA) under Article 26 of the ECT and the 1976

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<sup>499</sup> De Brabandere, *op. cit.*, pp. 351

<sup>500</sup> Editors of Sputnik news, "Close Look: Yukos Shareholders vs. Russia at European Court of Human Rights", 19 January 2017

<sup>501</sup> A. Newcombe, *op. cit.*, p. 291

<sup>502</sup> Editors of BBC News, "Russia puts its law above European court rulings", *BBC News*, BBC, London, 14 July 2015, (visited on 16 December 2016), available at: <http://www.bbc.com/news/world-europe-33521553>

<sup>503</sup> Editors of Sputnik, "Constitutional Court Absolves Russia From Paying \$2Bln to Ex-Yukos Shareholders", 19 January 2017

<sup>504</sup> Editors of Focus Business Services, *Cyprus-Russia Tax Treaty, Agreement of 5th December 1998*

<sup>505</sup> ECT was opened for signature on 17 December 1994 and entered into force on 16 April 1998. D. Nougayrède, "Yukos, investment round-tripping and the evolving public/private paradigms", 2015, pp. 351

<sup>506</sup> Note that GML shares owned by Khodorkovsky were settled into a Liechtenstein foundation and the latter settled in turn into the Guernsey trust.

<sup>507</sup> T. Geraint, "Asset Protection Trusts", paragraph 6.1

<sup>508</sup> Leonid Nevzlin owned just over 70% of GML Ltd; Platon Lebedev, Mikhail Brudno, Vladimir Dubov and Vasily Shakhnovsky controlled each just under 7.5%. Note that Khodorkovsky had transferred his Yukos stakes to Nevzlin during his trial in 2005 in an attempt to reduce the impact of the tax collection campaign on the company.

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UNCITRAL Arbitration Rules:<sup>509</sup>

- Hulley Enterprises Limited<sup>510</sup> (Cyprus) v. The Russian Federation<sup>511</sup>,
- Yukos Universal Limited<sup>512</sup> (Isle of Man) v. The Russian Federation<sup>513</sup>,
- Veteran Petroleum Limited<sup>514</sup> (Cyprus) v. The Russian Federation<sup>515</sup>.

Even though ECT did not prevent governments from seizing or nationalizing commercial assets, it guaranteed a fair compensation against unfair seizure via arbitration (subject to no appeal). Thus, ECT appeared as a powerful tool for the Yukos majority shareholders. However, the application of ECT became a central issue to validate the jurisdiction. Indeed, ECT was signed on 17 December 1994 by the Russian Federation. However, the State Duma never ratified it and on 20 August 2009 the government declared its intention to not ratify, pursuant to Article 45(3)(a) of the ECT.<sup>516</sup>

According to treaty interpretation rules of Articles 31 and 32 of the Vienna Convention on the Law of Treaties<sup>517</sup> and the application of Article 45(1) of the ECT<sup>518</sup>, the three-person

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<sup>509</sup> Note that the three claimants maintained separate claims but the cases were treated in conjunction with the same tribunal. Interestingly, Daniel Price, the claimants' appointee arbitrator, resigned and was replaced on 24 September 2007 by Dr Charles Poncet

<sup>510</sup> Hulley Enterprises Limited held approximately 56.3% of OJSC Yukos Oil Company.

<sup>511</sup> Hulley Enterprises Ltd (Cyprus) v Russian Federation, PCA Case No AA 226, Final Award (18 July 2014) (Hon L Yves Fortier, Chairman; Dr Charles Poncet; Judge Stephen M Schwebel)

<sup>512</sup> Yukos Universal Limited held approximately 2.6 % of OJSC Yukos Oil Company.

<sup>513</sup> Yukos Universal Limited (Isle of Man) v The Russian Federation, UNCITRAL, PCA Case No AA 227, Final Award (18 July 2014) (Hon L Yves Fortier, Chairman; Dr Charles Poncet; Judge Stephen M Schwebel)

<sup>514</sup> Veteran Petroleum Limited was a corporate pension fund set up in 2001 and covering 30,000 ex-Yukos employees. It held approximately 11.6% of OJSC Yukos Oil Company.

<sup>515</sup> Veteran Petroleum Ltd (Cyprus) v Russian Federation, PCA Case No AA 228, Final Award (18 July 2014) (Hon L Yves Fortier, Chairman; Dr Charles Poncet; Judge Stephen M Schwebel)

<sup>516</sup> Article 45(3)(a) of the ECT reads as follows: "*Any signatory may terminate its provisional application of this Treaty by written notification to the Depository of its intention not to become a Contracting Party to the Treaty. Termination of provisional application for any signatory shall take effect upon the expiration of 60 days from the date on which such signatory's written notification is received by the Depository.*". Editors of the Energy Charter Secretariat, *Consolidated Version of the Energy Charter Treaty*; T. Gazzini, "Case comment: Yukos Universal Limited (Isle of Man) v The Russian Federation - Provisional Application of the ECT in the Yukos Case", 2015, pp. 293

<sup>517</sup> Article 31 (General rule of interpretation) of the Vienna Convention on the Law of Treaties reads as follows:

1. *A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.*

2. *The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:*

(a) *any agreement relating to the treaty which was made between all the parties in connexion with the conclusion of the treaty;* (b) *any instrument which was made by one or more parties in connexion with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.*

3. *There shall be taken into account, together with the context:*

(a) *any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;* (b) *any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;* (c) *any relevant rules of international law applicable in the relations between the parties.*

4. *A special meaning shall be given to a term if it is established that the parties so intended.*

Article 32 (Supplementary means of interpretation) of the Vienna Convention on the Law of Treaties reads as follows: *Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31: (a) leaves the meaning ambiguous or obscure; or (b) leads to a result which is manifestly absurd or unreasonable.*

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tribunal found that ECT provisionally applied to Russia from the date of its signature until 18 October 2009 (i.e. 60 days after the notification). Moreover, based on Article 45(3) of the ECT, the treaty was binding to investments made in Russia during the provisional application for a period of 20 years, i.e. 19 October 2029.<sup>519</sup> The tribunal considered that Russian domestic law approved the principle of provisional application of treaties. It read the Russian Constitution as silent on that point and included in its analysis Article 23 of the 1995 Federal Law on International Treaties of the Russian Federation that expressly admitted provisional application of treaties (even if that law was adopted after the signature of the ECT).<sup>520</sup> The tribunal also included the 1991 and 1999 versions of the Law on Foreign Investment that allowed international arbitration for investor-State disputes settlement and viewed signature of an agreement as an express consent of the state.<sup>521</sup> However, the opting-out mechanism of Article 45(2) of the ECT did not seem to be fully investigated<sup>522</sup> as subsequent tribunals did not validate the provisional application of ECT (see below).

As a related point, the tribunal also evaluated the ‘fork-in-the-road’ clause.<sup>523</sup> Based on three criteria, i.e. identity of the parties, cause of action and object of the dispute, it considered the proceedings before the Russian domestic courts and the ECtHR as different.<sup>524</sup>

On 18 July 2014, the arbitration tribunal issued its unanimous final awards. Noteworthy, the event was accompanied by a press conference.<sup>525</sup> The tribunal concluded against the

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Editors of Organization of American States, *Vienna Convention on the Law of Treaties*

<sup>518</sup> Article 45(1 and 2) of the ECT reads as follows:

(1) *Each signatory agrees to apply this Treaty provisionally pending its entry into force for such signatory in accordance with Article 44, to the extent that such provisional application is not inconsistent with its constitution, laws or regulations.*

(2)(a) *Notwithstanding paragraph (1) any signatory may, when signing, deliver to the Depository a declaration that it is not able to accept provisional application. The obligation contained in paragraph (1) shall not apply to a signatory making such a declaration. Any such signatory may at any time withdraw that declaration by written notification to the Depository.*

(2)(b) *Neither a signatory which makes a declaration in accordance with subparagraph (a) nor Investors of that signatory may claim the benefits of provisional application under paragraph (1).*

(2)(c) *Notwithstanding subparagraph (a), any signatory making a declaration referred to in subparagraph (a) shall apply Part VII provisionally pending the entry into force of the Treaty for such signatory in accordance with Article 44, to the extent that such provisional application is not inconsistent with its laws or regulations.*

<sup>519</sup> T. Gazzini, “Case comment: Yukos Universal Limited (Isle of Man) v The Russian Federation - Provisional Application of the ECT in the Yukos Case”, pp. 293

<sup>520</sup> Article 23(1) of the Federal Law on International Treaties of the Russian Federation, 34 ILM 1370 (16 June 1995) reads as follows: ‘*An international treaty or a part thereof may, prior to its entry into force, be applied by the Russian Federation provisionally if the treaty itself so provides or if an agreement to such effect has been reached with the parties that have signed the treaty*’.

<sup>521</sup> Law No. 1545–1 of the RSFSR on Foreign Investments in the RSFSR (4 July 1991); T. Gazzini, “Case comment: Yukos Universal Limited (Isle of Man) v The Russian Federation - Provisional Application of the ECT in the Yukos Case”, 2015, pp. 300

<sup>522</sup> Evaluation of article 45 of ECT, especially the opting-out option of paragraph 2, would have been better refined if non-English versions of the text had been studied. T. Gazzini, “Case comment: Yukos Universal Limited (Isle of Man) v The Russian Federation - Provisional Application of the ECT in the Yukos Case”, 2015, pp. 298

<sup>523</sup> As presented in the publicly-available decision of *Pantechniki S.A. Contractors & Engineers (Greece) v. The Republic of Albania*, ICSID Case No. ARB/07/21, the tribunal held that the claimant’s earlier local court proceedings were deemed to be final and thus precluded it from recourse to international arbitration (before ICSID under the 1991 Albania-Greece bilateral investment treaty in that case).

<sup>524</sup> *Yukos Universal Limited (Isle of Man) v The Russian Federation*, Interim award on jurisdiction and admissibility, PCA Case No. AA 227, 30 November 2009, paragraphs 598-600, pp. 213

<sup>525</sup> A. Newcombe, *op. cit.*, p. 283

Russian Federation due to a breach of its obligations under Article 13(1) of ECT.<sup>526</sup> The tribunal reviewed in detail the facts through nearly 300 pages while the legal study of expropriation by itself occupied only five and a half pages.<sup>527</sup> The harsh tax collection process combined with arrests of top management members and forced sale of key assets was viewed as an equivalent to 'nationalization or expropriation', i.e. an indirect expropriation. The tribunal considered that the upper members of the Russian administration and government as well as state-owned OJSC Rosneft were involved in this creeping expropriation.<sup>528</sup> Even if Article 13(1) of ECT did not expressly leave freedom of case-by-case appreciation, the tribunal did so.<sup>529</sup> It studied the indirect aspect of expropriation in the light of:<sup>530</sup>

- (a) The degree of economic impact of the government measures on the investment. In the current case, the tax collection measures led to the direct disruption and bankruptcy of the company;
- (b) The interference of the government measures with the reasonable and legitimate investor expectations. Here, the investors could not have legitimately expected to see the company destroyed and some of the head staff arrested;
- (c) The character of the governmental measures. In the present case, measures appeared manifestly excessive even if initially some claims could have been legitimate.

Thus indirect expropriation was admitted.

Subsequently, based on Article 13 of ECT, legality of expropriation was analysed according to the following criteria:<sup>531</sup>

- (a) Expropriation for a public interest purpose. Here, state-owned OJSC Rosneft benefited from the governmental action, which was a 'profoundly questionable' public interest;
- (b) Non-discriminatory expropriation. In the present case, the tribunal preferred not to decide;

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<sup>526</sup> Paragraph 1 of Article 13 (expropriation) of ECT reads as follows: *Investments of Investors of a Contracting Party in the Area of any other Contracting Party shall not be nationalized, expropriated or subjected to a measure or measures having effect equivalent to nationalization or expropriation (hereinafter referred to as 'Expropriation') except where such Expropriation is:*

- (a) for a purpose which is in the public interest;*
- (b) not discriminatory;*
- (c) carried out under due process of law; and*
- (d) accompanied by the payment of prompt, adequate and effective compensation.*

*Such compensation shall amount to the fair market value of the Investment expropriated at the time immediately before the Expropriation or impending Expropriation became known in such a way as to affect the value of the Investment (hereinafter referred to as the "Valuation Date").*

*Such fair market value shall at the request of the Investor be expressed in a Freely Convertible Currency on the basis of the market rate of exchange existing for that currency on the Valuation Date. Compensation shall also include interest at a commercial rate established on a market basis from the date of Expropriation until the date of payment.*

<sup>527</sup> A. Newcombe, *op. cit.*, pp. 285, 287 and 289

<sup>528</sup> C.S. Gibson, "Case comment: Yukos Universal Limited (Isle of Man) v The Russian Federation: A Classic Case of Indirect Expropriation", pp. 303

<sup>529</sup> The tribunal might have been inspired by the Annex 8-A (Expropriation) of the EU-Canada free-trade Comprehensive Economic and Trade Agreement: *"The Parties confirm their shared understanding that: 2. The determination of whether a measure or series of measures of a Party, in a specific fact situation, constitutes an indirect expropriation requires a case-by-case, fact-based inquiry that considers, among other factors:*

- (a) the economic impact of the measure or series of measures, although the sole fact that a measure or series of measures of a Party has an adverse effect on the economic value of an investment does not establish that an indirect expropriation has occurred;*
- (b) the duration of the measure or series of measures of a Party;*
- (c) the extent to which the measure or series of measures interferes with distinct, reasonable investment-backed expectations; and*
- (d) the character of the measure or series of measures, notably their object, context and intent.*

<sup>530</sup> C.S. Gibson, *op. cit.*, pp. 308

<sup>531</sup> *Ibid.*, pp. 312

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- (c) Lawful expropriation. Here, the tribunal didn't viewed the expropriation as 'carried out under due process of law' but rather 'bent to the will of Russian executive authorities to bankrupt Yukos, assign its assets to a State controlled company, and incarcerate a man who gave signs of becoming a political competitor';
  - (d) Payment of prompt, adequate and effective compensation. In the current case, no compensation of any kind was supplied.

The tribunal concluded that the Yukos case was a non-compensated indirect expropriation and thus illegal.

Interestingly, the tribunal found suspicious the withdrawal of nine years of audit reports by Yukos' auditor PwC in 2007. The tribunal disregarded the auditor's statement 'that "new information" had led it to conclude that such reports could no longer be relied upon as trustworthy'. The tribunal rather considered the withdrawal as a proof of pressure from the Russian authorities. It confirmed that 'Yukos was the object of a series of politically-motivated attacks by the Russian authorities that eventually led to its destruction'.<sup>532</sup>

However, the tribunal neglected the evaluation of the legality of Yukos' 'tax optimization scheme' in Russian low-tax regions as it didn't identify its own role as a court applying Russian law.<sup>533</sup>

For the quantification of the damages for the unlawful expropriation, two questions were particularly important: the valuation method and the valuation date.<sup>534</sup>

The definition of the valuation date was based on two elements: (i) the definition of the date of the expropriation and (ii) the entitlement of the claimants to choose a valuation based on either the expropriation date or the award date. Both parties identified the date of the expropriation as 'the date on which the incriminated actions first lead to a deprivation of the investor's property that crossed the threshold and became tantamount to expropriation.' Considering that the case was a composite act, the tribunal based its analysis on Article 15 of the International Law Commission (ILC) on state responsibility.<sup>535</sup> By doing so, the date could be restricted to the main action (or omission) sufficient to constitute the wrongful act, such action was not necessarily the last of the sequence.<sup>536</sup> And as suggested by the Russian Federation, the tribunal found that 'the threshold to the expropriation of Claimants' investment was crossed earlier than in November 2007'<sup>537</sup> and that 'a substantial and irreversible deprivation of Claimants' assets occurred on 19 December 2004, the date of the Yuganskneftegaz (YNG) auction [which was] Yukos' main production asset'.<sup>538</sup> Regarding the valuation based on either the expropriation date or the award date, the arbitrators followed the recent arbitral practice (i.e. the valuation date does not have to necessarily be the date of the

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<sup>532</sup> A. Newcombe, *op. cit.*, p. 287

<sup>533</sup> *Ibid.*, p. 285

<sup>534</sup> I. Marboe, "Case comment: Yukos Universal Limited (Isle of Man) v The Russian Federation - Calculation of Damages in the Yukos Award: Highlighting the Valuation Date, Contributory Fault and Interest", p. 326

<sup>535</sup> Article 15 (Breach consisting of a composite act) of Chapter I (General principles) of Part one (The internationally wrongful act of a state) in The International Law Commission Report reads as follows: '1. The breach of an international obligation by a State through a series of actions or omissions defined in aggregate as wrongful occurs when the action or omission occurs which, taken with the other actions or omissions, is sufficient to constitute the wrongful act. 2. In such a case, the breach extends over the entire period starting with the first of the actions or omissions of the series and lasts for as long as these actions or omissions are repeated and remain not in conformity with the international obligation.' M. Sassòli, A. Bouvier and A. Quintin, *International Law Commission Report on the work of its fifty-third session*

<sup>536</sup> I. Marboe, *op. cit.*, pp. 327

<sup>537</sup> The tribunal mentioned that the present arbitration differed from the case of Quasar de Valores SICAV SA, Orgor de Valores SICAV SA, GBI 9000 SICAV SA and Alos 34 SL v The Russian Federation (cf. below)

<sup>538</sup> I. Marboe, *op. cit.*, p. 327



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expropriation) and thus deviated from the strict application of ECT.<sup>539</sup> Following *ADC v Hungary*<sup>540</sup>, the key elements of the analysis referred to (i) the lawfulness of the expropriation and (ii) the potential increased value of the property post expropriation. In the case of an unlawful expropriation and a growing value of the property, the valuation date had to rather be the date of the award.<sup>541</sup> However, the tribunal reminded that the claimant retained the final choice between the expropriation date and the award date when the expropriation was unlawful.<sup>542</sup> Here, both hypotheses were quantified and the highest damage amount was selected.<sup>543</sup>

For the valuation method, the tribunal considered types of damages: (i) the value of the shares of the shareholders, (ii) the value of the putative dividends to be paid until the valuation date, and (iii) the pre-award interest.<sup>544</sup> Regarding the valuation of the shares, the tribunal disregarded the discounted cash flow method and the comparable transactions method. Noteworthy, the arbitrators did not consider the price of the Yukos shares while in other cases they did so (see below). The tribunal privileged the comparable companies method and determined in the years 2004, 2007 and 2014 the Russian Trading System Oil and Gas Index.<sup>545</sup> The missed dividends were quantified by comparing the share value at the expropriation date with the share value at the award date. The pre-award interest was added on top. There, the arbitrators based their calculation on the most appropriate 'alternative investment'<sup>546</sup> recommended by previous investment tribunals: the US Treasury bond rates.<sup>547</sup> The rate was equal to the average yield of 10-year US Treasury bonds in the period between 1 January 2005 and 30 May 2014, which was 3.389%.<sup>548</sup>

When applying the two methods of calculation, the damage reached US\$ 21.988 billion on the expropriation date while it was US\$ 66.694 billion at the award date. Obviously, the claimants chose the award date as it offered the largest amount.<sup>549</sup>

Additionally, the tribunal evaluated the complaints of alleged 'unclean hands',<sup>550</sup> against the claimants. Based on Article 39 of ILC<sup>551</sup> on state responsibility, two 'material and significant'

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<sup>539</sup> A. Shepard, "The Distinction between Lawful and Unlawful Expropriation", p. 196

<sup>540</sup> *ADC Affiliate Limited and ADC & ADMC Management Limited v Republic of Hungary*, ICSID Case No ARB/03/16, Award (2 October 2006)

<sup>541</sup> *Case Concerning the Factory at Chorzow (Germany v Poland)*, Permanent Court of International Justice 1928 Series A No 17, 47; *Case of Papamichalopoulos and Others v Greece*, App 14556/89 (Just Satisfaction) The European Court of Human Rights in Series A, No 330-B (31 October 1995) paras 36–7; *Amoco International Finance Corp v Iran* (1987) 15 Iran-USCTR 189, paragraph 193; *Philippis Petroleum Co v Iran* (1989) 21 Iran-USCTR 79, paragraph 110

<sup>542</sup> *I. Marboe, op. cit.*, pp. 329

<sup>543</sup> *Ibid.*, pp. 329

<sup>544</sup> *Ibid.*, p. 330

<sup>545</sup> Russian Trading System Oil and Gas Index refers to the prices of trades on the Moscow Stock Exchange executed in securities.

<sup>546</sup> USA was the global reference economy; US dollar was the global reference currency; and all claims were calculated in US dollars.

<sup>547</sup> *Siemens v Argentine Republic* (n 29) paragraph 396; *Compania del Desarrollo de Santa Elena SA v Republic of Costa Rica*, ICSID Case No. ARB/96/1, Award (17 February 2000) paragraph 104; *Alpha Projektholding GmbH v Ukraine*, ICSID Case No. ARB/07/16, Award (8 November 2010) paragraph 514; *EDF International SA and others v Argentine Republic*, ICSID Case No. ARB/03/23, Award (11 June 2012) paragraphs 1325 ff; *Gemplus SA and others v United Mexican States*, ICSID Case No. ARB(AF) 04/3 and 04/4, Award (16 June 2010) paragraphs 16–24

<sup>548</sup> *I. Marboe, op. cit.*, pp. 334

<sup>549</sup> *Ibid.*, pp. 330

<sup>550</sup> The 'unclean hands' doctrine originates from the dissenting opinion of Judge Schwebel (later an arbitrator of the majority shareholders' arbitration cases) in the case concerning the Military and Paramilitary Activities in and against Nicaragua (*Nicaragua v United States of America*) (Merits) [1986] International Court of Justice Report 14: "*Nicaragua has not come to Court with clean hands. On the contrary, as the aggressor, indirectly responsible—but ultimately responsible—for large*

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actions of Yukos could have had an impact on the assessment of liability and damages: (i) Yukos' 'abuse of the low-tax regions by some of its trading entities' and (ii) its 'questionable use of the Cyprus-Russia Double Tax Agreement'<sup>552</sup>. Consequently, 'in the exercise of its wide discretion' the tribunal considered that 25% of the prejudice was Yukos' fault.<sup>553</sup> The damages of US\$ 66.694 billion were accordingly reduced to US\$ 50,020,867,798.<sup>554</sup>

Therefore, while the claims reached US\$ 114 billion in reparation, the cumulated final award<sup>555</sup> on 28 July 2014 included over US\$ 50 billion in damages and almost US\$ 70 million in arbitration and legal costs.<sup>556</sup> The award represented 20% of Russia's annual budget.<sup>557</sup>

In its statements, the tribunal considered the case as 'a full assault on Yukos and its beneficial owners in order to bankrupt Yukos and appropriate its assets while, at the same time, removing Mr. Khodorkovsky from the political arena'.<sup>558</sup>

As the Russian Federation voluntarily missed the deadline to pay the full sum in January 2015<sup>559</sup>, started the enforcement issues. Indeed, enforcement of awards is in principle possible in any of the 152 States of the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.<sup>560</sup> However, it may quickly prove to be problematic when the State is reluctant to pay<sup>561</sup> and especially when the award does not benefit from Article 54 of the Washington Convention<sup>562</sup> as it is the case here.<sup>563</sup> Indeed, the award needs

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*numbers of deaths and widespread destruction in El Salvador apparently much exceeding that which Nicaragua has sustained, Nicaragua's hands are odiously unclean*".

<sup>551</sup> Article 39 of Chapter I (General principles) of Part one (The internationally wrongful act of a state) in The International Law Commission Report reads as follows: '*In the determination of reparation, account shall be taken of the contribution to the injury by wilful or negligent action or omission of the injured State or any person or entity in relation to whom reparation is sought.*' M. Sassòli, A. Bouvier and A. Quintin, *International Law Commission Report on the work of its fifty-third session*

<sup>552</sup> The general effect of the Cyprus/Russia Double Tax Agreement of December 2005 was that Cyprus-registered offshore entities that had tax exemptions in Cyprus enjoyed the same exemptions in the Russian Federation. After being blacklisted as 'uncooperative territory' in 2008, Cyprus co-signed a new agreement in April 2009, which was updated in 2010 and fully applicable in 2015. There, when more than half the company's assets comprise Russian immovable property, Russian Federation is able to apply its domestic capital gains tax, according to standard OECD model tax convention.

<sup>553</sup> Reference to: Occidental Petroleum Corporation v Ecuador (n 62) paragraph 687 (also chaired by Yves Fortier); MTD Equity Sdn Bhd v Chile, ICSID Case No. ARB/01/7, Award (25 May 2004) paragraphs 243 and 246.

<sup>554</sup> A. Llamzon, "Case comment: Yukos Universal Limited (Isle of Man) v The Russian Federation - The State of the 'Unclean Hands' Doctrine in International Investment Law: Yukos as both Omega and Alpha", pp. 315; I. Marboe, *op. cit.*, pp. 332

<sup>555</sup> Hulley Enterprises Ltd (Cyprus), Yukos Universal Limited (Isle of Man) and Veteran Petroleum Ltd (Cyprus) were respectively awarded US\$ 39.9 billion, US\$ 1.85 billion and US\$ 8.2 billion in damages.

<sup>556</sup> A. Newcombe, *op. cit.*, p. 283

<sup>557</sup> B. Knowles, K. Moyeed and N. Lamprou, "The US\$50 billion Yukos award overturned – Enforcement becomes a game of Russian roulette", 13 May 2016

<sup>558</sup> *Ibid.*

<sup>559</sup> J. Fouret and P. Daureu, "Case comment: Yukos Universal Limited (Isle of Man) v The Russian Federation - Enforcement of the Yukos Awards: A Second Noga Saga or a New Sedelmayer Fight?", pp. 336

<sup>560</sup> G.B. Born, *International Commercial Arbitration*, p. 2980

<sup>561</sup> Note that USSR and subsequently Russia have never complied voluntarily with an investment arbitration award.

<sup>562</sup> The Washington Convention or Convention on the Settlement of Investment Disputes between States and Nationals of Other States states at its article 54(1) that: "*Each Contracting State shall recognize an award rendered pursuant to this Convention as binding and enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgment of a court in that State. A Contracting State with a federal constitution may enforce such an award in or through its federal*

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to be executory in the state of origin and local proceedings over before trying enforcement abroad. The related principle is to avoid double exequatur.<sup>564</sup> As the seat of arbitration was the Hague, Russia went before the Hague District Court on 12 November 2014. For the first time in 20 years, the court overturned the arbitration awards, i.e. the three interim and three final awards against Russia. The Hague District Court considered that the PCA tribunal wrongly interpreted the ECT signed in 1994 but never ratified by Russia as a valid ground (through article 26) for obtaining jurisdiction.<sup>565</sup>

With the Hague District Court ruling, enforcement against Russia's overseas assets didn't appear promising. If GML Ltd (behind the three claimants) decided to launch attachment proceedings in another jurisdiction, Russia could use Article VI of the New York Convention to paralyse such attachment/recognition proceedings until (i) the Dutch courts definitively rule on Russia's setting-aside proceedings, and then (ii) object to the attachment procedure as such before the other courts.<sup>566</sup> Moreover, Article V(1)(e) of the New York Convention left each national court the discretion to either observe or not the Hague Court's refusal of enforcement.<sup>567</sup> Thus, enforcement of the PCA award became difficult in France, Belgium, Germany, UK, USA and India. As an illustration, in France and Belgium only, US\$ 1 billion of Russian assets were frozen for some time. However, Belgium, under Russian "recommendations", decreed a 'Yukos law' that enhanced sovereign immunity protection by requiring the decision of a judge to attach assets. In France, seizures of assets from companies that were debtors of Russian public entities heavily failed. The French courts held that such Russian companies were unbound to the Russian state debts.<sup>568</sup>

If considering other cases such as Sedelmayer arbitration, it required careful identification of jurisdictions and multiple attempts over 10 years to recover "only" US\$ 2,350,000.<sup>569</sup>

Additionally, the precise identification of commercial assets is crucial to increase chances of success, as sovereign immunity may be broad. As the New York convention does not clearly define sovereign immunity, the United Nations Convention on Jurisdictional Immunities of States and Their Property could be used but it is a recent treaty with a limited number of ratified member states.<sup>570</sup> Thus local law applies in most cases. However, previous cases can help definition of commercial assets.<sup>571</sup> Current and fixed assets that are directly used for

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*courts and may provide that such courts shall treat the award as if it were a final judgment of the courts of a constituent state."*

<sup>563</sup> J. Fouret and P. Daureu, *op. cit.*, pp. 337

<sup>564</sup> J. Fouret and P. Daureu, *op. cit.*, pp. 338

<sup>565</sup> B. Knowles, K. Moyeed and N. Lamprou, *loc. cit.*

<sup>566</sup> Article VI of the New York Convention reads as follows: "*If an application for the setting aside or suspension of the award has been made to a competent authority referred to in article V paragraph 1 (e), the authority before which the award is sought to be relied upon may, if it considers it proper, adjourn the decision on the enforcement of the award and may also, on the application of the party claiming enforcement of the award, order the other party to give suitable security.*". J. Fouret and P. Daureu, "Case comment: Yukos Universal Limited (Isle of Man) v The Russian Federation - Enforcement of the Yukos Awards: A Second Noga Saga or a New Sedelmayer Fight?", 2015, p. 339

<sup>567</sup> Article V(1)(e) of the New York Convention reads as follows: "*Recognition and enforcement of the award may be refused, at the request of the party against whom it is invoked, only if that party furnishes to the competent authority proof that: (e) The award has not yet become binding on the parties, or has been set aside or suspended by a competent authority of the country in which, or under the law of which, that award was made.*". J. Fouret and P. Daureu, "Case comment: Yukos Universal Limited (Isle of Man) v The Russian Federation - Enforcement of the Yukos Awards: A Second Noga Saga or a New Sedelmayer Fight?", 2015, p. 339

<sup>568</sup> B. Knowles, K. Moyeed and N. Lamprou, *loc. cit.*

<sup>569</sup> Franz Sedelmayer v The Russian Federation through the Procurement Department of the President of the Russian Federation, SCC, Award (7 July 1998); J. Fouret and P. Daureu, *op. cit.*, pp. 340

<sup>570</sup> United Nations Convention on Jurisdictional Immunities of States and their Property (adopted 2 December 2004) UN Doc A/59/508; J. Fouret and P. Daureu, *op. cit.*, pp. 341

<sup>571</sup> J. Fouret and P. Daureu, *op. cit.*, pp. 341

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diplomatic purposes<sup>572</sup>, material (e.g. ship) belonging to a university<sup>573</sup> were considered unseizable. Paintings of national value were politically viewed as national cultural treasure and thus not subject to confiscation.<sup>574</sup> However, rent payments of buildings unused by the diplomaic delegation were seizable.<sup>575</sup> Most interestingly, enforcement could be targeted to OJSC Rosneft and OJSC Gazprom, as state-owned companies and thus potentially viewed as the Russian state commercial assets.<sup>576</sup>

Taken together, knowing that courts (notably in France and in USA according to US Federal Arbitration Act) do not enforce arbitral awards that have been set aside in the country of origin, Yukos majority shareholders have limited expectations. However, cases with minority shareholders proved successful (see below). Moreover, lawyers for the former Yukos majority shareholders stated that they will appeal to the Court of Appeal in the Hague and eventually to the Supreme Court of the Netherlands. Therefore, the case is still ongoing.<sup>577</sup>

## 5. Arbitration Cases of Minority Shareholders

European minority shareholders of OJSC Yukos Oil Company managed to initiate suits against Russia at the Arbitration Institute of SCC on the basis of BITs.

### a. RosInvestCo UK Ltd v The Russian Federation<sup>578</sup>

In May 2006, the minority shareholder RosInvestCo UK Ltd, an affiliate of Elliott Associates (a US holding company of hedge funds), found ground for arbitration thanks to a British-Russian BIT.<sup>579</sup>

The tribunal adopted the most favoured nation clause and thus viewed the Russian actions against OJSC Yukos Oil Company as an unlawful expropriation.<sup>580</sup>

Even if the value of shares had increased after expropriation, the tribunal did not take into consideration this point.<sup>581</sup> The award of US\$ 3.5 million<sup>582</sup> covered only the purchase price of the shares as claimants had invested (or more precisely speculated) while tax actions had started, i.e. between November and December 2004.<sup>583</sup> At that time, the claimants were expected to have grasped the hazardous situation of the company. However, such approach of the tribunal to cover only the purchase price was against the law of State responsibility.<sup>584</sup> The restitution or if not possible the financial compensation was expected to cover the damage at the time it occurred. The jurisprudence had exemplified the point in *ADC v Hungary*: the valuation date of an unlawful expropriation was at the time of the award.<sup>585</sup>

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<sup>572</sup> Embassy of the Russian Federation and others v NOGA, Cour d'Appel de Paris, Judgment on 10 August 2000, (2001) 26 YB Commercial Arbitration 273

<sup>573</sup> The Murmansk State Technical University (MSTU) and others v Compagnie NOGA d'importation et d'exportation, Tribunal de Grande Instance, Brest on 24 July 2000, (2001) 3 Gaz Pal 801

<sup>574</sup> J. Fouret and P. Daureu, *op. cit.*, p. 342

<sup>575</sup> Russian Federation v Franz J Sedelmayer, Supreme Court of Sweden Case No. 170-10 (1 July 2011); A. Reinisch, "Enforcement of Investment Awards", p. 671 and 687

<sup>576</sup> J. Fouret and P. Daureu, *op. cit.*, pp. 343

<sup>577</sup> B. Knowles, K. Moyeed and N. Lamprou, *op. cit.*

<sup>578</sup> RosinvestCo UK Ltd v The Russian Federation, Final Award (12 September 2010)

<sup>579</sup> M. Goldhaber, "A lifetime of litigation - the fall of Yukos", 9 July 2010

<sup>580</sup> I. Marboe, "Quasar de Valores SICAV SA and others v The Russian Federation, Another Chapter of the Yucos Affair", p. 252

<sup>581</sup> *Ibid.*, p. 252

<sup>582</sup> RosinvestCo UK Ltd v The Russian Federation, Final Award (12 September 2010), paragraph 675

<sup>583</sup> I. Marboe, "Quasar de Valores SICAV SA and others v The Russian Federation, Another Chapter of the Yucos Affair", p. 252

<sup>584</sup> J. Crawford, *The International Law Commission's Articles on State Responsibility: Introduction, Text and Commentaries*, pp. 218

<sup>585</sup> ADC Affiliate Limited and ADC & ADMC Management Limited v Republic Hungary, ICSID Case No. ARB/03/16, Award (2 October 2006), paragraphs 496-99

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**b. Quasar de Valores SICAV SA, Orgor de Valores SICAV SA, GBI 9000 SICAV SA and Alos 34 SL v The Russian Federation<sup>586</sup>**

In March 2007, Spanish minority investors called for arbitration.<sup>587</sup> The related award on 20 July 2012 brought the following 5 decisions of legal interest.

Firstly, article 6 on nationalization and expropriation of the Spanish-Russian BIT mentioned the right to receive ‘adequate compensation, without undue delay and in freely convertible currency’. However, according to Article 10, arbitration between a first state and an investor from the second state was acceptable only in case of disputes ‘relating to the amount or method of payment of the compensation due under article 6’. Arbitrators considered that the existence of the three requirements of Article 6, i.e. existence of grounds of public use, conformity with legislation in force in the territory, absence of discrimination, were corresponding to the criteria of international lawfulness and thus were related to the remaining part of Article 6, i.e. adequate compensation. The tribunal considered that Article 6 acknowledged by itself international lawfulness of arbitration as long as it focused on the topic of Article 10. Thus arbitrators had to evaluate only the compensation of the internationally lawful expropriation. Such approach was against Russia’s position. The tribunal considered that the present case differed from *Berschader v Russia*, where BIT between Belgium–Luxembourg Economic Union and the Soviet Union excluded ‘disputes concerning whether or not an act of expropriation actually occurred under Article 5’.<sup>588</sup> This specification gave a narrow jurisdiction to the arbitrators. The present tribunal first identified if an internationally lawful expropriation had occurred and then defined the amount of the compensation.

Secondly, the tribunal evaluated globally whether an indirect expropriation occurred. Contrary to the approach of the Yukos case before the ECtHR (see above), here the BIT was used. It provided more specific protection to foreign investors. Focus on defining if actions resulted in expropriation. After a careful study of the succession of events, ‘the Russian Federation’s real “goal” was to expropriate OJSC Yukos Oil Company, and not to legitimately collect taxes’. Through the tax enforcement, 93% of Yukos’ assets were transferred in the end to the Russian state.<sup>589</sup> Contrary to *RosInvestCo UK Ltd v The Russian Federation*, distinction between unlawful and lawful expropriation was not considered as a relevant question.<sup>590</sup>

Thirdly, the method of valuation appeared to be unusual: ‘their proportionate share of Yukos’ market value’ as equivalent to the price of the shares of Yukos as traded on the stock market.<sup>591</sup> Indeed, the method could be greatly impacted by the volatility of the market. However, the tribunal saw the minority shareholders as investors with little own influence on the price and thus favored this approach.<sup>592</sup>

Fourthly, the related key issue with this method was to define the date of shares valuation. Identifying the date of expropriation appeared difficult as it occurred in stages. Knowing that investors made their investment in late 2003 (December 2003 to July 2004), the reference date was defined as 19 December 2003 (some days after the arrest of Khodorkovsky on 25

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<sup>586</sup> Quasar de Valores SICAV SA, Orgor de Valores SICAV SA, GBI 9000 SICAV SA and Alos 34 SL v The Russian Federation, Award (20 July 2012)

<sup>587</sup> Note that some of the initial claimants (i.e. Renta 4 SVSA, Ahorro Corporacion Emergentes FI, Ahorro Corporacion Eurofondo FI, Rovime Inversiones SICAV SA) were not granted legal personality under the applicable Spanish-Russian BIT. See Renta 4 SVSA, Ahorro Corporacion Emergentes FI, Ahorro Corporacion Eurofondo FI, Rovime Inversiones SICAV SA, Quasar de Valores SICAV SA, Orgor de Valores SICAV SA, GBI 9000 SICAV SA v The Russian Federation, SCC No. 24/2007, Award on Preliminary Objections (20 March 2009) (J. Paulsson, President; C.N. Brower; T.T. Landau), paragraph 131

<sup>588</sup> I. Marboe, “Quasar de Valores SICAV SA and others v The Russian Federation, Another Chapter of the Yucos Affair”, p. 248

<sup>589</sup> *Ibid.*, p. 248

<sup>590</sup> *Ibid.*, p. 249

<sup>591</sup> Quasar de Valores SICAV SA, Orgor de Valores SICAV SA, GBI 9000 SICAV SA and Alos 34 SL v The Russian Federation, Award (20 July 2012), paragraphs 187, 188 and 192

<sup>592</sup> I. Marboe, “Quasar de Valores SICAV SA and others v The Russian Federation, Another Chapter of the Yucos Affair”, pp. 250

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October 2003, but prior to the the release of the news about the tax claim and the freeze of the large Yukos' assets), where share value was at US\$ 10.80. Interestingly, the timing differed to *RosInvestCo UK Ltd v The Russian Federation*, where claimants had invested while tax actions had started, i.e. between November and December 2004. Then, in the present case, extrapolation up to the initiation of the procedure, i.e. 23 November 2007, was made by comparing the evolution of share values of 4 Russian competing companies. The award of US\$ 2,026,480 appeared to be 23% below the investors' claims.<sup>593</sup>

Fifthly, the tribunal negatively evaluated the fact that the claimants' proceedings were fully covered by a third party (unrelated the current case and unbound by BIT rules), i.e. the Menatep bank. Contrary to *Kardassopoulos v Georgia*<sup>594</sup>, the present tribunal considered that the absence of financial involvement of the claimants in the procedure had to be compensated by distributing 85% of the tribunal's costs to them.<sup>595</sup>

Subsequently, Russia challenged the decision. In 2014, the Stockholm District Court supported the Spanish funds award<sup>596</sup> but on 28 January 2016 the Swedish appeal court considered that the Arbitration Institute of the SCC had no ground to arbitrate the case.<sup>597</sup>

## **D. Key Legal Aspects**

### **1. General Principles of Law**

In the *Yukos Capital Sarl* case, the Amsterdam Court of Appeal regarded the Russian *arbitrazh* courts as not independent, which led to the use of the private international law.

In the arbitration cases of the majority shareholders and minority shareholders, the tribunal based the procedures on ECT and BITs respectively. All these treaties rely on the general principles of law.

In the Yukos case before the ECtHR, the ECHR was applied but the right to property was not explicit contrary to the previously mentioned treaties.

### **2. Expropriation**

While the ECtHR could not consider the concept of indirect expropriation, all the other tribunals did so. Indeed, contrary to ECHR, ECT and BITs provided more specific protection to foreign investors. As illustrated in the *Quasar de Valores SICAV SA, Orgor de Valores SICAV SA, GBI 9000 SICAV SA and Alos 34 SL v The Russian Federation* case, the arbitration tribunal granted an appropriate compensation as it validated the criteria of international lawfulness, i.e. the existence of grounds of public use, conformity with legislation in force in the territory, absence of discrimination.

Furthermore, in the arbitration cases of the majority shareholders, the court decided to adopt freedom of case-by-case appreciation.

Note that even though ECtHR limited its analysis to the right to property, it used its margin of appreciation.

### **3. Expropriation Compensation**

The method of valuation and the date of shares valuation appeared of major importance to quantify the value of the compensation. Regarding these two aspects, the approaches differed in all cases. The tribunals tried to use the approach that reflected the closer the financial strength of the investor. Thus, a minority shareholder had a low impact on the share value, and an investor that invested after the tax actions of the Russian authorities was mainly a speculator ready to take high risks.

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<sup>593</sup> *Ibid.*, pp. 251

<sup>594</sup> I. Kardassopoulos and R. Fuchs v Georgia, ICSID Case Nos ARB/05/18 and ARB/07/15, Award, 3 March 2010, paragraph 691

<sup>595</sup> I. Marboe, "Quasar de Valores SICAV SA and others v The Russian Federation, Another Chapter of the Yukos Affair", p. 253

<sup>596</sup> T. Moore, "Covington and Baker Botts act as Yukos minority shareholders defeat Russia"

<sup>597</sup> Editors of Interfax, *Sweden delivers judgment in favor of Russia in dispute with Yukos holders*

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#### 4. Unclean Hands Principle

In the arbitration cases of the majority shareholders notably, the unclean hands principle was applied even though it was not recognized as a general principle of international law.<sup>598</sup> It remains to define if the fact of having unclean hands triggers an immediate inadmissibility of all the claims of this party, or a proportionality (in comparison with all the facts of the case and the actions of the other party).<sup>599</sup>

#### 5. Procedural and Jurisdictional Issues

In most cases, the appeal courts found that the initial arbitration had no ground to arbitrate the case. Such approach continues to be debated. Are arbitration tribunals too liberal in their interpretation of the treaties? Or could we envisage that in some cases the appeal courts are bound to some superior national interests or limitative legal rules, which diverge from the interests of the proceedings?

Note however that the ECtHR did not found infringement of the principle of litispendence with the parallel arbitration cases of the majority shareholders.

#### 6. Enforcement

In these cases, most awards were public and even accompanied by a press conference.

Such method indeed pressured the Russian Federation but did not fully prove efficient to collect awards. As the cases evolved, the final settlement was in fact more confidential.

Furthermore, as illustrated in the Yukos capital *Sarl* case, the arbitration against a public company involved in the initial issue, i.e. OJSC Rosneft, proved to be more efficient to collect an indirect but tangible compensation.

### Conclusion

The Russian Bolshevik revolution led to ideological changes and thus expropriation of private property by decree from the novel executive organ.<sup>600</sup> The reaction of foreign (capitalist) states was mainly limited to the resistance to extraterritorial application of these decrees in their own courts.<sup>601</sup> Thus companies, which invested in USSR, were left alone to face expropriation. As an exception, the Lena Goldfields Ltd decided to fight back. Fortunately for itself, its concession agreement allowed calling for an international arbitration. Even though USSR rejected the option, a truncated tribunal awarded the company a significant compensation. Thus the empty-chair policy was not directly successful.<sup>602</sup> The case was innovative in different domains, notably the use of general principles of law, an expropriation compensation adjusted to the remaining profits, the recognition of a truncated tribunal as a valid court, procedural and jurisdictional issues (e.g. the definition of the doctrine of separability, the scope and the competence of the tribunal) and other aspects, such as the application of the "second-best evidence rule", the creation of contractual interest after the award and the publicity of the award. However, in the end the enforcement of the award proved difficult. Indeed, in response to the containment policy and economic suffocation organized by the West, Soviet Union minimized compensations. Lena Goldfields Ltd had to lobby before the British government to get a limited compensation some years later. Even though the final result was not fully conclusive, the creativity of Lena Goldfields case has

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<sup>598</sup> A. Llamzon, *op. cit.*, pp. 315

<sup>599</sup> *Ibid.*, pp. 325

<sup>600</sup> Z.L. Zile, "The Taking and Precariousness of Non-State Property in Soviet Law", pp. 203

<sup>601</sup> G. Nebolsine, "The Recovery of the Foreign Assets of Nationalized Russian Corporations", pp. 1130; *United States v. Pink*, 315 U.S. 203 (1942)

<sup>602</sup> It seems that the negative consequences of the empty-chair policy during the Lena Goldfields case did not help Stalin to avoid repeating such error when the Soviet boycott at the United Nations Security Council allowed USA to make the Council publish Resolution 83 on 27 June 1950 that recommended member states to provide military assistance to the Republic of Korea against the Democratic People's Republic of Korea. C. Malkasian, *The Korean War 1950-1953*, p. 16; L. Gross, "Voting in the Security Council: Abstention from Voting and Absence from Meetings", pp. 209

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proved to be useful even today.<sup>603</sup> Interestingly, during the troubled 1990s, the control of *Lenzoloto* (a former subsidiary of Lena Goldfields Ltd) by an Australian company Star Mining via a Russian/British Virgin Islands venture was forbidden due to threats to Russia's national security.<sup>604</sup> In 2004, *Lenzoloto* was transferred to a London-based holding (with Russian management team), Polyus Gold International Ltd.<sup>605</sup>

After the collapse of USSR, the attempt of fast economic and legal changes proved catastrophic. To regain control, the Russian government used harsh methods and rhetoric of law enforcement as illustrated by the cases related to OJSC Yukos Oil Company. Expropriation was still used to serve political policy.<sup>606</sup> As in the 1930s, foreign courts were limited to prevent consequences of the expropriation in their local non-Russian areas. The ECtHR appeared reluctant to protect property as such and to consider it as an entitlement.<sup>607</sup> Regarding investor protection treaties, the finding of a consistent jurisdiction was complex; practice was highly variable; and enforcement tools remained limited against a powerful state. The latter continued to consider that the protection of its subsoil, economy and people was above the interests of a few investors, especially when these investors had unclean hands. Chances of success in award enforcement increased when investors had some means of pressure on national companies that do international business, e.g. OJSC Rosneft, rather than directly targeting the Russian Federation.

Thus, international investment arbitration needs some strengthening to represent a credible deterrent to malpractice, especially from a powerful state.<sup>608</sup> On the other hand, the investors should also be strongly stimulated to improve their practice and to avoid having unclean hands. Moreover, all parties should be obliged to consider the protection of the planet and the optimization of the use of its natural resources as a whole. Indeed, to make a comparison with nuclear deterrents, these weapons of mass destruction create a stabilized geopolitical situation only when all parties are fully convinced that no escape exists. Here, international investment arbitration should become fully binding to any state, entity or party without exception to become credible at all time.<sup>609</sup> As long as this situation does not exist, economic responses (through trade and investment pressures in other fields), diplomatic pressure and military gestures will remain the key forces.

The limited natural resources of our planet may be an opportunity to build viable supranational institutions that can optimize international investment law. Furthermore, knowing that global warming will combine with the limitation of natural resources, international legal

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<sup>603</sup> Methods developed in the Lena Goldfields case were notably applied to (i) the Anglo-Iranian Oil Co. case (against the Iranian oil nationalization act of 1951), Judgement of July 22nd, 1952: International Court of Justice Reports 1952, p. 93; (ii) the Iran-United States Claims Tribunal (an international arbitral tribunal established pursuant to the Algiers Accords of 19 January 1981, after the US embassy hostage crisis in Tehran from 4 November 1979 to 20 January 1981 and the Iranian frozen assets as retaliation measures by the US administration of James Earl "Jimmy" Carter Jr. Editors of the Iran-United States Claims Tribunal, About the tribunal, 2012; V.V. Veeder, *op. cit.*, pp. 751 and 769

<sup>604</sup> N. Chenoweth, *Panama Papers: Malcolm Turnbull's path to Siberia and back*, The Australian financial review, 13 May 2016

<sup>605</sup> Editors of Polyus Gold International Ltd, *Case study*, Polyus Gold International Ltd, 2012. Polyus Gold International is presently the largest gold producer in Russia and one of the top ten in the world. In 2015, the Nicosi-based Wandle Holdings Limited acquired Polyus Gold International. Note that all the current management team is Russian.

<sup>606</sup> J. Gans-Morse, "Threats to Property Rights in Russia: From Private Coercion to State Aggression", pp. 263

<sup>607</sup> J.E. Stiglitz, *The price of inequality: How today's divided society endangers our future*, pp. 308

<sup>608</sup> O.T. Johnson Jr. and J. Gimblett, "From Gunboats to BITs: The Evolution of Modern International Investment Law", pp. 646

<sup>609</sup> We suggest to call such approach the "chessboard principle". Earth would be the chessboard, while the same rules would apply to all states and entities. Thus, no state or entity could claim to be out of the chessboard.



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initiatives should be activated to humanize business activities at large.<sup>610</sup> Instead of confrontation, maybe we should better realize that we all live on a small planet. We should learn to live together, as reminded in a speech of US President John Fitzgerald "Jack" Kennedy:

*We [USA and USSR] are both devoting massive sums of money to weapons that could be better devoted to combating ignorance, poverty, and disease. We are both caught up in a vicious and dangerous cycle in which suspicion on one side breeds suspicion on the other, and new weapons beget counter weapons.*

*In short, both the United States and its allies, have a mutually deep interest in a just and genuine peace and in halting the arms race. Agreements to this end are in the interests of the Soviet Union as well as ours; and even the most hostile nations can be relied upon to accept and keep those treaty obligations, and only those treaty obligations, which are in their own interest.*

*So, let us not be blind to our differences. But let us also direct attention to our common interests and to the means by which those differences can be resolved. And if we cannot end now our differences, at least we can help make the world safe for diversity. For, in the final analysis, our most basic common link is that we all inhabit this small planet. We all breathe the same air. We all cherish our children's future. And we are all mortal.*<sup>611</sup>

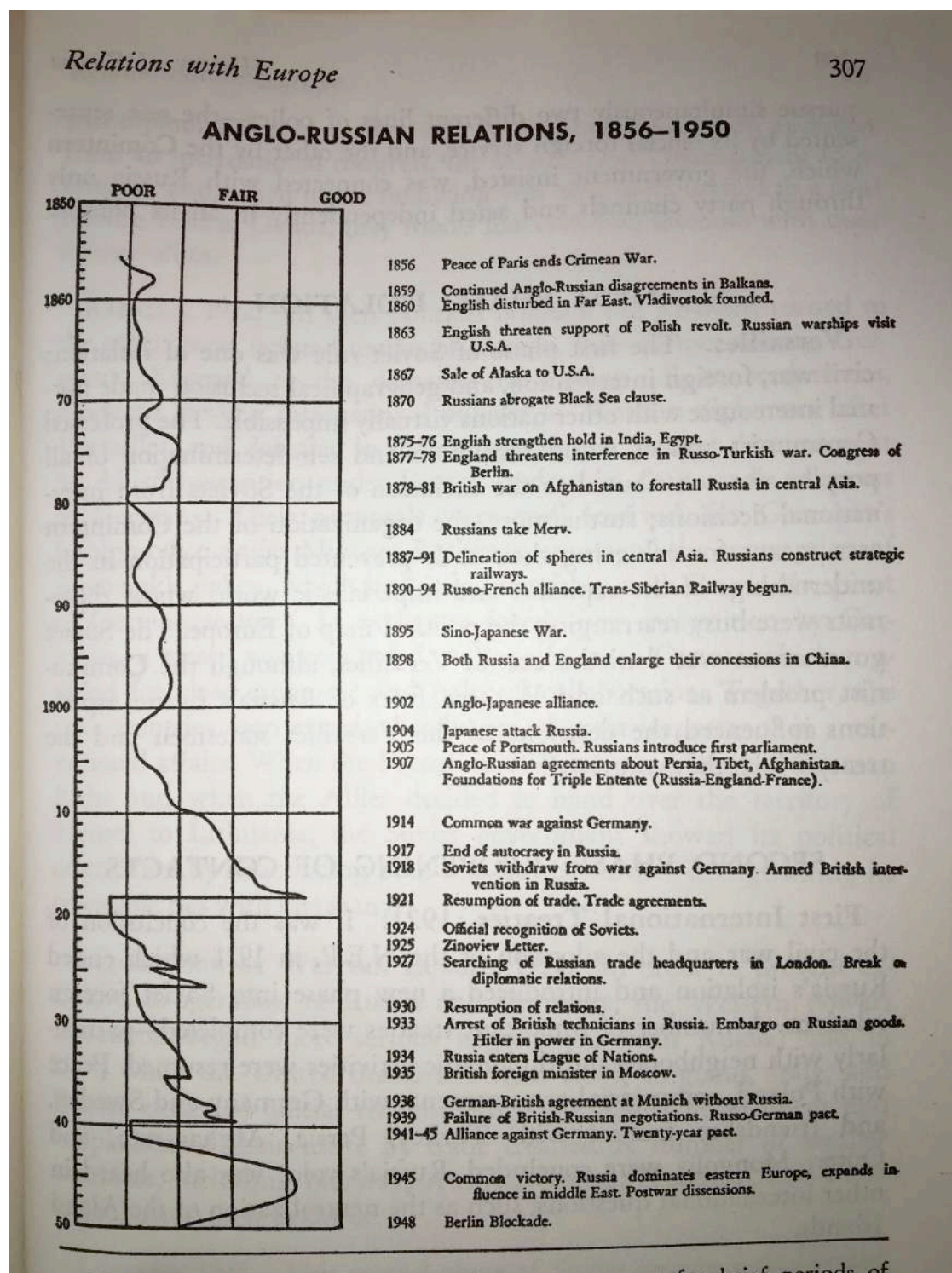
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<sup>610</sup> As an inspiration, the Measurement of Earth Data for Environmental Analysis (MEDEA) project, initiated by Vice-President Albert Arnold "Al" Gore Jr., saw the nearly-impossible collaboration from 1992 to 2001 of US and Russian intelligence agencies and scientists to improve global warming studies with images from spy satellites of both states. The project was reactivated by USA only under the presidential terms of Barack Hussein Obama II.

<sup>611</sup> J.F. Kennedy, *American University speech*, 10 June 1963

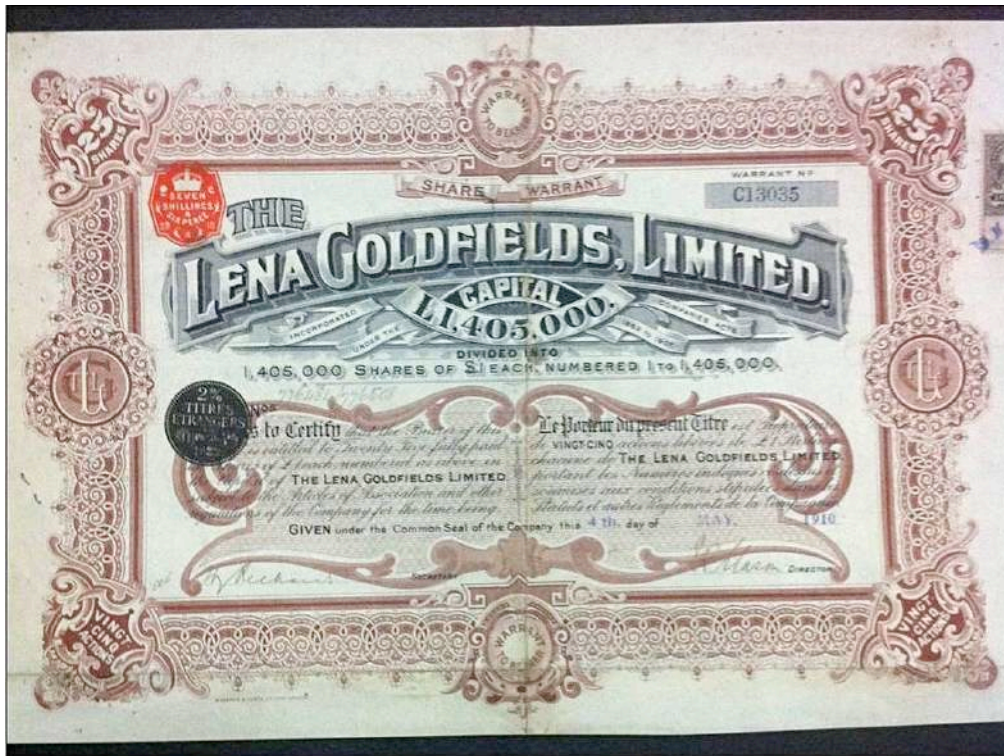
## Annexes

### Annex 1. Anglo-Russian Relations from 1856 to 1950<sup>612</sup>



<sup>612</sup> W. Kirchner, *op. cit.*, p. 307

**Annex 2.** Copy of a Lena Goldfields Ltd share warrant given on 4 May 1910<sup>613</sup>



<sup>613</sup> V. Khomutsky, "Lena massacre 1912" in *Historical Discussion Club*, MirTesen, 15 May 2015

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**Annex 3.** Pictures related to the 1912 Lena Massacre<sup>614</sup>



Workers of Lena goldfields Ltd in 1912



Corpses after the Lena massacre

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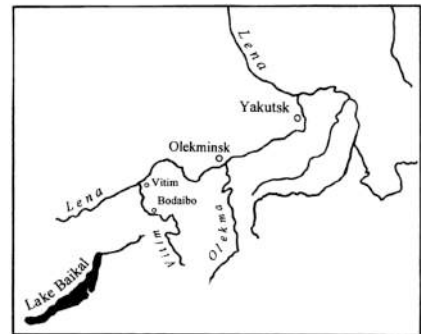
<sup>614</sup> V. Khomutsky, loc. cit.



Relatives of Lena-massacre victims in a cemetery



#### Annex 4. Location of the activities of Lena Goldfields Ltd<sup>615</sup>



<sup>615</sup> Note that RSFSR territory is depicted in red in the upper map. Personal adaptation from information in A.C. Sutton, *Western Technology and Soviet Economic Development 1917 to 1930*, pp. 95; M.S. Melancon, *The Lena Goldfields Massacre and the Crisis of the Late Tsarist State*, p. 3 and 7

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**Annex 5.** Trade Agreement Between His Britannic Majesty's Government and the Government of the Russian Socialist Federal Soviet Republic, 16 March 1921<sup>616</sup>

Whereas it is desirable in the interests both of Russia and of the United Kingdom that peaceful trade and commerce should be resumed forthwith between these countries, and whereas for this purpose it is necessary pending the conclusion of a formal general Peace Treaty between the Governments of these countries by which their economic and political relations shall be regulated in the future that a preliminary Agreement should be arrived at between the Government of the United Kingdom and the Government of the Russian Socialist Soviet Republic, hereinafter referred to as the Russian Soviet Government.

The aforesaid parties have accordingly entered into the present Agreement for the resumption of trade and commerce between the countries. The present Agreement is subject to the fulfilment of the following conditions, namely:

(a) That each party refrains from hostile action or undertakings against the other and from conducting outside of its own borders any official propaganda direct or indirect against the institutions of the British Empire or the Russian Soviet Republic respectively, and more particularly that the Russian Soviet Government refrains from any attempt by military or diplomatic or any other form of action or propaganda to encourage any of the peoples of Asia in any form of hostile action against British interests or the British Empire, especially in India and in the Independent State of Afghanistan. The British Government gives a similar particular undertaking to the Russian Soviet Government in respect of the countries which formed part of the former Russian Empire and which have now become independent.

(b) That all British subjects in Russia are immediately permitted to return home and that all Russian citizens in Great Britain or other parts of the British Empire who desire to return to Russia are similarly released. It is understood that the term "conducting any official propaganda" includes the giving by either party of assistance or encouragement to any propaganda conducted outside its own borders.

The parties undertake to give forthwith all necessary instructions to their agents and to all persons under their authority to conform to the stipulations undertaken above.

I.

Both parties agree not to impose or maintain any form of blockade against each other and to remove forthwith all obstacles hitherto placed in the way of the real trade between the United Kingdom and Russia in any commodities which may be legally exported from or imported into their respective territories to or from any other foreign country, and not to exercise any discrimination against such trade, as compared with that carried on with any other foreign country or to place any impediments in the way of banking, credit and financial operations for the purpose of such trade, but subject always to legislation generally applicable in the respective countries. It is understood that nothing in this Article shall prevent either party from regulating the trade in arms and ammunition under general provisions of law which are applicable to the import of arms and ammunition from, or their export to foreign countries. Nothing in this Article shall be construed as overriding the provisions of any general International Convention which is binding on either party by which the trade in any particular article is or may be regulated (as for example, the Opium Convention).

II.

British and Russian ships, their masters, crews and cargoes shall, in ports of Russia and the United Kingdom respectively, receive in all respects the treatment, privileges, facilities, immunities and protections which are usually accorded by the established practice of commercial nations to foreign merchant ships, their masters, crews and cargoes, visiting their

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<sup>616</sup> R.H. Ullman, *The Anglo-Soviet Accord*, pp. 474-478

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ports including the facilities usually accorded in respect of coal and water pilotage, berthing, dry docks, cranes, repairs, warehouses and generally all services appliances and premises connected with merchant shipping.

Moreover, the British Government undertakes not to take part in, or to support, measures restricting or hindering, or tending to restrict or hinder, Russian ships from exercising the rights of free navigation of the high seas, straits and navigable waterways, which are enjoyed by ships of other nationalities.

Provided that nothing in this Article shall impair the right of either party to take precautions as are authorised by their respective laws with regard to the admission of aliens into their territories.

### III.

The British and other governments having already undertaken the clearance of the seas adjacent to their own coasts and also certain parts of the Baltic from mines for the benefit of all nations, the Russian Soviet Government on their part undertake to clear the sea passages to their own ports.

The British Government will give the Russian Soviet government any information in their power as to the position of mines which will assist them in clearing passages to the ports and shores of Russia.

The Russian Government, like other nations, will give all information to the International Mine Clearance Committee about the areas they swept and also what areas still remain dangerous. They will also give all information in their possession about the minefields laid down by the late Russian Governments since the outbreak of war in 1914 outside Russian territorial waters in order to assist in their clearance.

Provided that nothing in this section shall be understood to prevent the Russian Government from taking or require them to disclose any measures they may consider necessary for the protection of their ports.

### IV.

Each party may nominate such number of its nationals as may be agreed from time to time as being reasonably necessary to enable proper effect to be given to this Agreement, having regard to the conditions under which trade is carried on in its territories, and the other party shall permit such persons to enter its territories, and to sojourn and carry on trade there, provided that either party may restrict the admittance of any such persons into any specified areas, and may refuse admittance to or sojourn in its territories to any individual who is persona non grata to itself, or who does not comply with this Agreement or with the conditions precedent thereto.

Persons admitted in pursuance of this Article into the territories of either party shall, while sejourning there for purposes of trade, be exempted from all compulsory services, whether civil, naval, military or other, and from any contributions whether pecuniary or in kind imposed as an equivalent for personal service and shall have right of egress.

They shall be at liberty to communicate freely by post, telegraph and wireless telegraphy, and to use telegraph codes under the conditions and subject to the regulations laid down in the International Telegraph Convention of St. Petersburg, 1875 (Lisbon Revision of 1908).

Each party undertakes to account for and to pay all balances due to the other of terminal and transit telegrams and in respect of transit letter mails in accordance provisions of the International Telegraph Convention and Regulations and of the Convention and Regulations of the Universal Postal Union respectively. The above balances when due shall be paid in the currency of either party at the option of the receiving party.



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Persons admitted into Russia under this Agreement shall be permitted freely to import commodities (except commodities such as alcoholic liquors of which both the importation and the manufacture are or may be prohibited in Russia) destined solely for their household use or consumption to an amount reasonably required for such purposes.

V.

Either party may appoint one or more official agents to a number to be mutually agreed upon to reside and exercise their functions in the territories of the other who shall personally enjoy all the rights and immunities set forth in the preceding Article and also immunity from arrest and search provided that either party may refuse to admit any individual as an official agent who is persona non grata to itself or may require the other party to withdraw him should it find it necessary to do so on grounds of public interest or security. Such agents shall leave access to the authorities of the country in which they reside for the purpose of facilitating the carrying out of this Agreement and of protecting the interests of their nationals.

Official agents shall be at liberty to communicate freely with their own Government and with other official representatives of their Government in other countries by post, by telegraph and wireless telegraphy in cypher and to receive and despatch couriers with sealed bags subject to a limitation of 3 kilograms per week which shall be exempt from examination.

Telegrams and radiotelegrams of official agents shall enjoy any right of priority over private messages that may be generally accorded to messages of the official representatives of foreign Governments in the United Kingdom and Russia respectively.

Russian official agents in the United Kingdom shall enjoy the same privileges in respect of exemption from taxation, central or local, as are accorded to the official representatives of other foreign Governments. British official agents in Russia shall enjoy equivalent privileges which moreover shall in no case be less than those accorded to the official agents of any other country.

The official agents shall be the competent authorities to visa the passports of persons seeking admission in pursuance of the preceding Article into the territories of the parties.

VI.

Each party undertakes generally to ensure that persons admitted into its territories under the two preceding Articles shall enjoy all protection, rights and facilities which are necessary to enable them to carry on trade, but subject always to any legislation generally applicable in the respective countries.

VII.

Both contracting parties agree simultaneously with the conclusion of the present Trade Agreement to renew exchange of private postal and telegraphic correspondence between both countries as well as despatch and acceptance of wireless messages and parcels by post in accordance with the rules and regulations which were in existence up to 1914.

VIII.

Passports, documents of identity, Powers of Attorney and similar documents issued or certified by the competent authorities in either country for the purpose of enabling trade to be carried on in pursuance of this Agreement shall be treated in the other country as if they were issued or certified by the authorities of a recognised foreign Government.

IX.

The British Government declares that it will not initiate any steps with a view to attach or to take possession of any gold, funds, securities or commodities not being articles identifiable as the property of the British Government which may be exported from Russia in payment for

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imports or as securities for such payment, or of any movable or immovable property which may be acquired by the Russian Soviet Government within the United Kingdom.

It will not take steps to obtain any special legislation not applicable to other countries importation into the United Kingdom of precious metals from Russia whether specie (other than British or Allied) or bullion or manufactures or the storing, analysing, refining, melting, mortgaging or disposing thereof in the United Kingdom, and will not requisition such metals.

X.

The Russian Soviet Government undertakes to make no claim to dispose in any way of the funds or other property of the late Imperial and Provisional Russian Governments in the United Kingdom. The British Government gives a corresponding undertaking as regards British Government funds and property in Russia. This Article is not to prejudice the inclusion in the general Treaty referred to in the Preamble of any provision the subject matter of this Article.

Both parties agree to protect and not to transfer to any claimants pending the conclusion of the aforesaid Treaty any of the above funds or property which may be subject to their control.

XI.

Merchandise the produce or manufacture of one country imported into the other in pursuance of this Agreement shall not be subjected therein to compulsory requisition on the part of the Government or of any local authority.

XII.

It is agreed that all questions relating to the rights and claims of nationals of either party in respect of Patents, Trade Marks, Designs and Copyrights shall be equitably dealt with in the Treaty referred to in the Preamble.

XIII.

The present Agreement shall come into force immediately and both parties shall at once take all necessary measures to give effect to it. It shall continue in force unless and until replaced by the Treaty contemplated in the Preamble so long as the conditions in both the Articles of the Agreement and in the Preamble are observed by both sides. Provided that at any time after the expiration of twelve months from the date on which the Agreement comes into force either party may give notice to terminate the provisions of the preceding Articles, and on the expiration of six months from the date of such notice these Articles shall terminate accordingly.

Provided also that if as the result of any action in the Courts of the United Kingdom with the attachment or arrest of any gold, funds, securities, property or commodities not being identifiable [sic] as the exclusive property of a British subject, consigned to the United Kingdom by the Russian Soviet Government or its representatives judgment is delivered by the Court under which such gold, funds, securities, property or commodities are held to be validly attached on account of obligations incurred by the Russian Soviet Government or by any previous Russian Government before the date of the signature of this Agreement, the Russian Soviet Government shall have the right to terminate the Agreement forthwith.

Provided also that in the event of the infringement by either party at any time of the provisions of this Agreement or of the conditions referred to in the Preamble, the other party shall immediately be free from the obligations of the Agreement. Nevertheless it is agreed that before taking any action inconsistent with the Agreement the aggrieved Party shall give the other party a reasonable opportunity of furnishing an explanation or remedying the default.

It is mutually agreed that in any of the events contemplated in the above provisions, the parties will afford all necessary facilities for the winding up in accordance with the principles of the Agreement of any transactions already entered into thereunder, and for the withdrawal and egress from their territories of the nationals of the other party and for the withdrawal of their movable property.

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As from the date when six months' notice of termination shall have been given under this Article, the only new transactions which shall be entered into under the Agreement shall be those which can be completed within the six months. In all other respects the provisions of the Agreement will remain fully in force up to the date of termination.

This Agreement is drawn up and signed in the English language. But it is agreed that as soon as may be a translation shall be made into the Russian language and agreed between the Parties. Both texts shall then be considered authentic for all purposes.

Signed at London, this sixteenth day of March, nineteen hundred and twenty-one.

R. S. HORNE.

L. KRASSIN.

#### DECLARATION OF RECOGNITION OF CLAIMS

At the moment of signature of the preceding Trade Agreement both parties declare that all claims of either party or of its nationals against the other party in respect of property or rights or in respect of obligations incurred by the existing or former Governments of either country shall be equitably dealt with in the formal general Peace referred to in the Preamble.

In the meantime and without prejudice to the generality of the above stipulation the Russian Soviet Government declares that it recognises in principle that it is liable to pay compensation to private persons who have supplied goods or services to Russia for which they have not been paid. The detailed mode of discharging this liability shall be regulated by the Treaty referred to in the Preamble.

The British Government hereby makes a corresponding declaration.

It is clearly understood that the above declarations in no way imply that the claims referred to therein will have preferential treatment in the aforesaid Treaty as compared with any other classes of claims which are to be dealt with in that Treaty.

Signed at London, this sixteenth day of March, nineteen hundred and twenty-one.

R. S. HORNE.

L. KRASSIN.

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**Annex 6.** Article 90 of the 1925 Concession Agreement: The Arbitration Clause  
English Translation<sup>617</sup>

- (A) All disputes and misunderstandings concerning the interpretation or performance of this agreement and all appendices thereto, on the declaration of either party, shall be examined and settled by an arbitration court.
- (B) The arbitration court shall consist of 3 (three) members, one of whom shall be selected by the Government, one by Lena and the third, who is to be the super-arbitrator, shall be selected by mutual agreement of the parties.
- (C) If such agreement is not reached within 30 (thirty) days from the day of receipt by the defendant party of a written request to appear before the arbitration court, setting out the matters in dispute and designating the member of the arbitration court selected by the claimant party, then within 2 (two) weeks the Government shall nominate 6 (six) candidates from amongst the professors of the Freiberg Mining Academy or of the Royal High Technical School of Stockholm from whom Lena shall select one as super-arbitrator within a period of 2 (two) weeks.
- (D) If Lena fails to select the super-arbitrator within the above-mentioned period of 2 (two) weeks, there being no insuperable obstacles to prevent such selection, the Government shall be entitled to request the council of one of the above-mentioned higher academic institutions to appoint a super-arbitrator from amongst the 6 (six) candidates nominated by the Government.
- (E) If the Government, in the absence of insuperable obstacles, fails to nominate the 6 (six) candidates for super-arbitrator within the above-mentioned period of 2 (two) weeks, Lena shall be entitled to request the council of one of the above-mentioned higher academic institutions to nominate 6 (six) candidates and to appoint a super-arbitrator from amongst their number, as set out above.
- (F) If, upon receipt of the summons from the super-arbitrator appointing the date and place of the first session, one of the parties, in the absence of insuperable obstacles, fails to send its arbitrator to the arbitration court or the arbitrator avoids participating in the arbitration court, then the matter in dispute shall, at the request of the other party, be settled by the super-arbitrator and the other member of the court, such settlement to be valid only if unanimous.
- (G) The arbitration court shall appoint a permanent secretary, who shall keep records of all proceedings of the court's sessions. The remuneration of the president and the secretary of the court, as well as the latter's expenses shall be paid by both parties in equal proportions. Each of the parties shall pay its own arbitrator and his expenses, as well as the costs connected with the conduct of its case before the arbitration court.
- (H) Matters to be settled by the arbitration court must be presented in written form to the president of the court, and the party bringing a claim must serve the other party with a copy of its declaration to the court. The super-arbitrator shall appoint the place and date for the first session to be held by the arbitration court.
- (I) When appointing the date and place for a session of the court, both the super-arbitrator and the arbitration court shall give consideration to:
  - (1) the reasonable period of time required for each party to make preparations for departure and arrival on time at the appointed place and
  - (2) the accessibility of the place being such that each party can reach it by the date fixed.

However, if either party encounters insuperable obstacles in having its court member or its representative reach the appointed place on time, all measures must be taken by that

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<sup>617</sup> The 30 April 1925 Lena Goldfields Ltd. Concession Agreement, as amended to 9 June 1927, published in Moscow in 1928 and subsequently appended to the related Award. V.V. Veeder, *op. cit.*, pp. 790

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party to inform the super-arbitrator or the arbitration court of such circumstance in a timely manner.

- (J) In any case, in the event of the failure to appear by one party's court member, the super-arbitrator or the arbitration court shall, on declaring a session open, pass a special motivated resolution on this matter.
- (K) The arbitration court shall have full power thereafter to fix the place and time of its sessions, as well as to settle methods and order of procedure. It shall be obligatory on each of the parties to supply to the court, at the time it requires, all necessary evidence relating to the case which it can and is able to produce, regard being had to such as may be of state importance.
- (L) All decisions of the court must in each case be made in written form and a copy of each decision must immediately be notified to the parties. Every majority decision of the court shall be final and binding for both parties and shall immediately be put into execution.
- (M) If the arbitration court comes to a decision requiring one of the parties to do something or to refrain from doing something, it shall at the same time decide upon and alert that party in advance of the consequences for failing to carry out its decision, namely, it shall impose in such case the payment of a certain penalty upon the other party, or it shall authorise the other party to carry out whatever was neglected at the expense of the defaulting party, or it shall declare the agreement annulled, the latter only at the request of the claimant party.

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**Annex 7.** Text of the English Translation of the Award in the Lena Goldfields Ltd, as published in *The Times* (London) on 3 September 1930<sup>618</sup>

[Nos. 1 to 4 are introductory.]

5. The chief clauses of Article 90 of the Agreement read as follows:

I. All disputes and misunderstandings in regard to the construing or fulfillment of this Agreement and of all schedules thereto, on the declaration of either of the parties, are examined and settled by the Court of Arbitration.

II. The Court of Arbitration shall consist of 3 (three) members, of which one shall be elected by the Government and the other by Lena, and the third the super-arbitrator shall be elected by both parties by mutual agreement.

III. If such agreement cannot be reached within 30 (thirty) days from the day of receipt by the defendant party of a summons in writing to attend the Court of Arbitration, setting out the matters in dispute and stating the member of the Court of Arbitration appointed by the plaintiff, the Government within the period of 2 (two) weeks appoints 6 (six) candidates from among the professors of the Freiberg Mining Academy or the Royal High Technical School of Stockholm, from among whom within a period of 2 (two) weeks Lena shall elect one, who will be the super-arbitrator.

IV. and V....

VI. If on receipt of the summons from the super-arbitrator appointing the time and place of the first session, one of the parties, in the absence of insurmountable obstacles to such action, does not send its arbitrator or if the latter refuses to take part in the Court of Arbitration, then, at the request of the other party, the matter in dispute is settled by the super-arbitrator and the other member of the Court, on condition that such decision is unanimous.

6. It will be observed that by paragraph I. of Article 90, the parties agreed to refer to arbitration every kind of dispute and misunderstanding in regard to either the construing or the fulfillment of the contract, and that each party was entitled to that right of access to an Arbitration Court without any further consent from the other. It was proved to the satisfaction of the Court in the course of the trial that Lena would not have entered into the Concession Agreement at all but for the presence in the contract of this arbitration clause and of the preceding clause (Article 89), whereby it was mutually agreed that "the parties base their relations with regard to this agreement on the principle of good will and good faith, as well as on reasonable interpretation of the terms of the agreement."

7. The Court was duly constituted by correspondence between the parties during February and March last.

8. The terms of reference defining the scope of the Court's jurisdiction, and the issues which, by accepting their arbitral office, the members of the Court became bound to try, are defined by three telegrams, subject to such further elucidation in detail as the parties might think fit or be ordered by the Court to give in their written declarations under paragraph VIII. of Article 90, or in their explanations and evidence (paragraph XII.).

By far the most important issues so referred were (a) the contention by Lena that the Government had "created for Lena undue difficulties and interference, and, in fact, the impossibility as regards performing its part of the Concession Agreement, and had prevented Lena from carrying out the Concession Agreement, or enjoying the rights, privileges, and benefits thereby created;" and (b) Lena's consequent claim for the ascertainment by the Court of what compensation is due to Lena from the Government. Certain other claims were made by Lena which are subsequently particularized in Lena's declaration to the Court mentioned in paragraph XIII. hereof.

To the submission to arbitration of these two main issues so raised by Lena, the Government, in its answer of February 25, 1930, agreed without qualifications, although in the

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<sup>618</sup> A. Nussbaum, *op. cit.*, pp. 42

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same telegram, and also in its telegram of March 1, it raised further issues by way of defence and counterclaim. These included contentions that Lena, by failure to perform its obligations in regard to payment of royalties, and in regard to the programmes of production and expenditure on development laid down in the Concession Agreement, had committed breaches on which the Government presumably intended to rely as a defence to Lena's main claim.

But in neither telegram did the Government mention the provisions of Article 86, which authorizes dissolution of the Concession Agreement by the Court on proof that Lena, "by its own fault," has failed to perform her undertakings in regard to royalties, production, and expenditure. By reason of the Government's abstention from any further active part in the arbitration, the Government's said contentions were not further developed.

9. By telegram, dated April 27, 1930, to the Chairman of the Court, signed jointly, both parties requested that the first session of the Court should be fixed for May 9, 1930, and the Chairman fixed the first session accordingly.

10. By two telegrams of May 5, 1930, from the Chairman of the Concessions Committee to the Chairman of the Arbitration Court and to Lena respectively the Government contended that Lena, by stating that it took no further responsibilities, by refusing further financing, and by withdrawing the powers of attorney from its representatives, had dissolved the Concession Agreement; and the Government further said that in these circumstances the Arbitration Court had ceased to function. On inquiry by the Chairman of the Court Lena replied submitting that the Arbitration Court was properly and completely constituted, and saying that it would attend on May 9.

11. On May 9 the first session was duly held, although neither the Government nor its arbitrator attended. In answer to the Government's contention above-mentioned counsel for Lena contended that the Concession Agreement necessarily continued to exist until formally dissolved by the Court under Article 86; he pointed out that the claim of Lena in the telegram of February 12, 1930, demanding arbitration, was that the Government had by its conduct in breach of the contract made performance of the Concession Agreement impossible, and he submitted that if Lena succeeded in establishing that allegation to the satisfaction of the Court it would then, and not till then, be the time for the Court to declare the Concession Agreement dissolved.

The Court decided that the Concession Agreement was still operative and that according to the plain language of Article 90, paragraph 6, the jurisdiction of the Court remained unaffected, and accordingly dealt with the preliminary questions of procedure. A copy of the order of the Court was duly sent to each party-to the Government as well as to Lena.

12. The Government, however, adhered to its decision not to attend the arbitration, still contending that Lena had caused the jurisdiction basis of the Court agreed on by both parties to be invalid. This contention Lena denied.

13. On May 29 Lena delivered its statement of claims.

14. As the Government persisted in wholly repudiating the Court and all the arbitration proceedings, the Court, on an application by Lena pursuant to the leave reserved in the Court's order of May 9, fixed the next preliminary hearing for June 19, and on that date gave directions for the trial on August 6 in London at the Royal Courts of Justice. A copy of the order was duly sent to the Government.

15. The Government did not, however, avail itself of the said liberty and did not attend the trial. The Court was thus deprived of the assistance of the opposing party in testing and checking the contentions and evidence of Lena. Although the Government has thus refused its assistance to the Court, it still remains bound by its obligations under the Concession Agreement and in particular by the terms of Article 90, the arbitration clause of the contract. By paragraph 12 of that Article each party undertook "to present to the Court, in manner and period in accordance with its instructions, all the information necessary respecting the matter

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in dispute, which it is able and which it is in a position to produce, bearing in mind considerations of State importance."

This information, by reason of the premises, the Court was not able to obtain direct from the Government, and in order to ascertain the truth upon the issues before it, the Court was thus compelled to admit the best evidence available of various facts and documents, upon which Lena was unable to produce primary evidence by reason of the documents or witnesses being in Russia and not available at the trial. The Court finds as a fact upon the evidence that this was rendered necessary by the difficulty in which the company found itself of getting either documents or persons out of Russia for the purposes of the trial.

16. The Concession Agreement by Article 1 granted to Lena exclusive rights of exploration and mining over certain vast areas of territory. In addition Article 2 granted the right of searching and prospecting in accordance with the Statute of Mining, 1923, over the whole of the rest of the territory of the U.S.S.R., and in the first and third districts mentioned below granted a further and exceptional right to Lena of prospecting and adding new areas to the concession without being bound in certain respects by the said Mining Statute. The territories over which Article 1 granted the said rights were:

(1) The Lenskoi-Vitimsk Mining District, containing some 15,000 to 20,000 square kilometres or over 7,000 square miles, and situate about 1,000 kilometres north-east of the Lake Baikal in Eastern Siberia.

(2) The Sissertski and Revdinski districts in the Urals, containing some 4,000 square kilometres, equal to 1,500 square miles.

(3) The Zmeinogorski and Zirianovski regions in the Altai, containing some 30,000 square kilometres, or about 12,000 square miles.

Of these concessions No. 1 contains chiefly gold, of which there are large deposits in and under the alluvial gravel. No. 2 contains chiefly iron ore and copper ore, with small percentages of the precious metals. No. 3 contains chiefly complex ores of copper, lead, and zinc, with small percentages of the precious metals.

For the purpose of the company's metallurgical works in the Altai and the Urals Article 1 granted the company the right to exploit coalmines in the Kuznetski Coal Basin, near the Altai district, and anthracite deposits in the Egorshinsk region east of the Urals; the list of plans of the mines to be transferred was to be settled by a joint committee before February 19, 1926 (Article 1, paragraphs 4 and 5, and Notes 1 to 4 thereto).

In addition valuable rights (some outside the concession territory) to timber exploitation, water power, agricultural land, building sites, etc., were conferred on Lena (Articles 3 to 9).

17. The duration of these concessions was for Lenskoi-Vitimsk 30 years, and for all other enterprises provided by the concession agreement 50 years from August 18, 1925 (Article 13), with certain qualifications in Article 1 not now material. All enterprises then working were to be transferred as going concerns with all plant, supplies, etc., and delivery of possession was to be made not later than within three months (coal and anthracite within six months, Article 1) from August 18, 1925—i.e., it was due on November 19, 1925, five days after the execution of the concession agreement (Article 10).

18. Other terms of primary importance in the concession agreement are the following:

(a) Lena was to develop the whole of the concessions with the highest skill and knowledge known to modern science in the whole world (Article 37).

(b) Lena undertook to comply with certain minimum programmes of development and production (Articles 39 to 49) inter alia to invest during the first seven years of the concession 22,000,000 roubles in development (Article 38); to pay certain royalties by way of percentages on production (Articles 50 to 58, 60 to 62), and make certain payments for surface plots (Article 63) and timber (Article 64); and pay taxes on equality with Government enterprises subject to certain exceptions (Article 69).

(c) (Subject to certain limitations and qualifications which are not material to the general epitome contained in the present paragraph) Lena was given very complete rights of user of the concession (Article 14), freedom to buy and sell in the markets of the U.S.S.R.



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(Articles 18 and 20), to import without import duty for seven years (Article 17), to export without licence duty but subject to large rights of pre-emption by the Government (Article 21), of transport (Articles 22 to 25); and generally Lena was given complete freedom of contract for all business purposes (Articles 15, 16, 28, and 29 which is with Schedule 13 particularly important in regard to freedom of finance, banking, and exchange and Articles 30 and 31).

(d) All payments by each party to the other were to be calculated and effected in British sterling or U.S.A. dollars (Article 81).

(e) The Government undertook responsibility for all losses caused as a result of breach of the Concession Agreement by organizations of central or local power, or illegal actions thereby (Article 80). The Court finds as a fact that under the Soviet law the trade unions and the various labour authorities were such "organizations."

(f) Lena was permitted to employ staff and labour, Russian and foreign, on certain conditions laid down in Articles 70 to 74, one of which was that the employees and workmen should enjoy equal rights with those granted to employees and workmen of Government enterprises (Article 71), another that Lena should observe all labour laws (Articles 70 and 73), and a third that no committees of the trade unions should possess the right to interfere in the "administrative economical activities of Lena" (Article 71).

(g) The Government undertook to supply the necessary police and military protection sufficient to guarantee the safety of the whole of Lena's property, particularly the safe production of precious metals (Article 35).

(h) Lena undertook to give the Government complete information as to, and the right to take part in all exploration work—no doubt in order that the Government might have full knowledge of the mineral wealth of the U.S.S.R. discovered by the company (Article 67); but no Government institution, either central or local, was to have any right to investigate the company's financial or commercial operations and Lena was not to be "bound to admit anyone to the examination of or to present information anywhere regarding the means employed by it or its enterprises for acquiring, working, and treating the various metals and minerals or other subsidiary products, as well as its plans, drawings, and other data of a secret character the publication of which would have a harmful effect on the activities of Lena (Article 68).

(i) Lena was to submit to all existing and future legislation, but subject to the extremely important qualification "in so far as special conditions are not provided in this agreement" (Article 75); and the Government undertook not to make any alteration in the Agreement by Order, Decree, or other unilateral act or at all except with Lena's consent (Article 76). The result of Articles 75 and 76 was completely to protect Lena's legal position-i.e., to prevent the mutual rights and obligations of the parties under the contract being altered by any act of the Government, legislative, executive, or fiscal, or by any action of local authorities or trade unions.

(j) A general implication of the agreement is that Lena, although a capitalist enterprise, was to enjoy "most-favoured-nation" treatment as compared with Government enterprises of a commercial character, and not to be penalized for being capitalists in a Socialist State.

19. In the year 1925, when Lena entered into the Concession Agreement, the policy of the Russian Government was to encourage the entrance into Russia of commercial and industrial enterprises conducted on ordinary individualistic lines as so-called "capitalist" concerns, in order to encourage development and promote employment in the U.S.S.R. This was what was then known as "the New Economic Policy:"

Lena was a concern of the kind; and the Court finds as a fact that if this policy had been continued and if the Concession Agreement had been carried out by the Government in accordance with its true meaning which inter alia implied and demanded a continuance of that policy, at least towards the Lena company would have encountered no insuperable difficulties up to the present time, would have had credit to obtain all necessary financial assistance in the great money centres of the world and would in fact have been by now far advanced on the road to very great prosperity.

Even as it is, and in spite of many breaches of the Concession Agreement by the Government from the very outset which created great difficulties in the company's performance and enjoyment of the Concession Agreement, Lena succeeded in the first three years of the concession in making a net profit to the amounts of £251,000, £117,000, and £391,000

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respectively.

But by the autumn of 1929 a radically different policy had been adopted by the Government-the so-called "Five-Year Plan"-which meant the development of the U.S.S.R. and of all its industries, commerce, banking, agriculture, transport, and indeed its whole economic life on purely Communistic principles, and brought with it a bitter class war against capitalistic enterprise and everyone connected with such enterprise. With the "Five-Year Plan" a capitalistic concern like Lena, conducting its manifold enterprises on ordinary commercial and individualist lines, was radically incongruous, however obedient it might be to the laws of the U.S.S.R., or however purely commercial and non-political it might be in its behaviour, as the Court finds that Lena in fact was.

The Five-Year Plan thus put Lena into a position in the Communist State where it became peculiarly exposed to hostile criticism. The official Soviet Press has been filled with such attacks in an increasing degree during the last 12 months. As an equally inevitable consequence Lena has been regarded as a capitalist outcast by the Communist public of the U.S.S.R.

This complete reversal in 1929 of the official policy of 1925 towards Lena necessarily meant, when measured in terms of contractual obligation, the breach by the Government of many of the fundamental provisions, express and implied, of the Concession Agreement. Open markets ceased to exist. The Government became the only buyer of the company's production. The Government became the only seller of the company's supplies and Lena had under the contract *inter alia* to feed and clothe all its employees and workmen. Difficulties with labour organizations and authorities became incessant and overpowering, and Lena's workmen became in the words of its counsel "untouchables". Banking and exchange facilities were denied it. Difficulties with Government departments and local authorities multiplied in intensity. The end was inevitable; how it was brought about is explained in the latter part of this Award.

20. In regard to the claims of the Government against Lena, as outlined in the Government's telegrams agreeing to and defining the terms of reference (see paragraph 8 of this Award), and generally as regards the question of Lena's performance of its contractual obligations, the Court finds as a fact that,

(a) During the 4 1/2 years from August, 1925, Lena invested nearly £3,500,000 sterling in the development of mines and works as against her undertaking in Articles 38, 47, 48, and 49, to invest for that purpose in the first seven years from that date 22,000,000 roubles, or on the Government's official valuation of the rouble, say £2,250,000 sterling, i.e., £1,250,000 sterling more, in 22 years less than the contract required.

(b) Lena performed the obligations of Article 37, which required the highest modern skill and knowledge, in both development and operating, with extraordinary success, engaging the very best advice on each aspect of the many difficult technical problems to be solved, acting with deliberation, but translating the final expert decisions into instant action, and ordering and installing the best modern plant and machinery without any delay on the part of Lena.

(c) Lena not only gave to the Government full information about exploration work as required by Article 67, but, in addition, of its own initiative volunteered full information about its processes for treating its ores, although in its opinion Article 68 permitted it to keep secret the processes if it chose. It thus enabled the Government to utilize in the Government's own metallurgical works vast resources of similar ore in the districts of the U.S.S.R. not included in the company's concession.

(d) Lena in general duly carried out its obligations under the Concession Agreement, save in so far as it was directly or indirectly prevented (i.) by the Government or by subordinate authorities for whose acts and defaults the Government had under the Concession Agreement accepted responsibility (Article 80), or (ii.) by force majeure (Article 83).

Apart altogether from the fact that the Government did not appear before the Court to prosecute its claims (if any) and prove them by evidence, and that, therefore, they must be rejected, the Court is satisfied that even if the Government case had been put and proved before it, whatever claims for damages could have been substantiated are amply covered by the very generous allowances in favour of the Government which the Court has made in the

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assessment of the amount due to Lena. The Court therefore rejects the claims by the Government against Lena.

21. There is, however, an allegation by the Government against Lena, not made in the telegrams mentioned in the last paragraph, with which the Court conceives it its duty to deal. In the telegrams of May 5, 1930, to the Chairman of the Court, and of the same date to Lena in London, contending that the Concession Agreement had been dissolved by Lena, and that this Court had ceased to function, as pointed out above in paragraph 10 of this Award, the Government referred to what is described as "the refusal by Lena further to finance its enterprises," and in various recent articles published by the Government in its Press, which were put in evidence before the Court, the Government alleged that the company was alone responsible.

Although this issue of finance was not raised by the Government in the telegrams defining the terms of reference, the matter is necessarily one which the Court has had to consider, since it affects the readiness and willingness of Lena to perform its contract; and in view of the fact that the Government did not attend the arbitration, the Court has given special attention to the whole of the evidence bearing on the financial history of the company and its relations with the Government, and has reached the conclusion that the Government was the cause of Lena's financial difficulties.

The following are some of the chief contributing factors:

(a) The total gold production by Lena in the 4 1/2 years was 1,844 Russian poods (a pood = say 16 kilogrammes or 36 lb. avoirdupois), for which at London prices in accordance with Article 21 of the contract, the Government, which bought the whole, ought to have paid about £3,250,000 sterling. The Government, in fact, in breach of the Concession Agreement, insisted both on paying in roubles and on calculating the equivalent of the London price in roubles at an exchange rate officially fixed by itself, without regard to the world value of the Russian rouble, at 9.45 roubles to the £1 sterling.

This official rate assumed for the rouble is very much greater value than it really possessed on the average of the 4 1/2 years since 1925. The true ratio cannot be ascertained with certainty, as the rouble has not been quoted on foreign exchanges, and no test of the market value of gold in Russia was possible as Lena's freedom of sale granted by Article 20 was made a nullity so far as gold is concerned by the Government forbidding any person in Russia to buy gold, subject, according to the evidence, to the penalty of death.

It was said in evidence that latterly the rouble was not worth more than 40 to the £1, or one-quarter of the official value; and as a result the company appears during the 4 1/2 years to have received for its gold less than it ought to have under the contract by at least, say, £1,000,000 sterling. It is, however, unnecessary for the Court to arrive at any precise conclusion on this point, as the company did not make any actual claim for further payment.

(b) There was a large loss of gold by theft, which Lena in its evidence put at 30 per cent to 40 per cent, or, say, £1,000,000 sterling. This loss, which we do not doubt was serious, would have been reduced to very much smaller proportions if the Government had carried out its obligations under Articles 35 and 80, in regard to police protection and the control of local authorities, whose duty it was to help the company's administration.

(c) The Government wrongfully, in breach of Article 2, refused to Lena valuable extensions of the gold area of the Concessions in the Lenskoi-Vitimsk district, called Kollara and Kitejamacha, which, according to the evidence, were discovered by Lena in 1927 and ought to have been available to Lena for working in 1928. These gold-bearing areas are to-day being worked by the Government, who state officially that they expect to employ there next year 5,000 workmen. The Court cannot estimate what amount of profits the company would have made there in 1928, 1929, and 1930, but they would probably have been substantial.

(d) The Government wrongfully refused similar extensions in the Urals (Elizavetinsky iron mines) and in the Altai (Hair-Kumin fire-clay deposits). The Elizavetinsky iron-ore deposits were just outside the Sissertski area of Article 1 of the Concession Agreement, but contiguous to the deposits within the Concession which fed the modern Sverdlovsk furnaces erected by the company. It was entitled as of right to the grant under Article 2.

The Hair-Kumin area was in 1928 treated by the Government as included in the Altai district conceded by Article 1; but anyhow the company was entitled to it under Article 2.

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According to the evidence, it contained the only fire-clay deposits of the Altai district and was therefore of great importance for making, e.g. the linings of furnaces. In consequence of the deprivation Lena was forced to import from Germany at great cost.

It is noteworthy that the date of the Government's definitive repudiation of these two very important rights of Lena was October, 1929. Both Elizavetinsky and Hair-Kumin would have afforded valuable additions to the company's assets, and would have increased its future profits.

(e) According to the evidence the Government wrongfully prevented Lena from working a large deposit of marble, which was of a kind both suitable and necessary as limestone flux for metallurgical smelting. This deposit was within the Concession area of Article 1, and Lena had a right to work it. In consequence of the deprivation Lena was forced to buy or work inferior limestone at a greater cost.

(f) The Government for not less than 15 months, namely, till June, 1927, delayed transferring to the company the coal and anthracite mines, which were essential for its metallurgical production, and should under the Concession Agreement have been available for the company's exploitation early in March, 1926. Early delivery was important in order to avoid delay in designing the furnaces suitable for the kinds of fuel available.

(g) The Government in breach of their obligations under the combined effect of Article 71, paragraph 1, and Article 80, paragraph 2, caused many of the workmen and employees of Lena to lose trade union rights and political rights (e.g., of voting); and in addition in 1929 it launched and fomented a class war against all persons employed by Lena, on the ground that the company was a capitalist enterprise. By reason of the premises the Government gradually caused the whole staff of Lena, higher and lower, technical and non-technical, to resign in large numbers.

This led to disorganization, and it became more and more difficult, and finally impossible, to get the necessary qualified men in those remote places to carry on. This attitude of the Government and of "all organizations of central and local power" (Article 81), including the trade unions, and the various Labour authorities from the lowest to the highest, acting under the Government's encouragement, culminated in a raid directed by the Central Government and carried out by the O.G.P.U. ("the Federal Political Police"), on the night of December 15, 1929.

(h) The raid was executed simultaneously on that night at practically every one of the numerous establishments of Lena throughout its vast concessions. These remote places were situated at great distances apart, and many of them far from railways. Bodaibo, the centre of the gold concession in Eastern Siberia, was 4,500 miles from Moscow; the chief centre of the Altai concession was 2,400 miles from Moscow, and Sverdlovsk, the chief town of the Ural concession, was over 1,300 miles from Moscow.

About 131 men, including the highest officials of the company, managers, metallurgists, electrical engineers, mine managers, and chiefs of the operating departments, were all seized and their persons and premises searched and their papers, including a mass of confidential documents, such as plans, reports, and investigations into processes necessary for the scientific operation of the various works, were taken away. About 12 of these officials were arrested, and some were subsequently prosecuted in the Soviet Court at Moscow on charges of "counter-revolutionary activity and espionage" against the Government.

Immediately after the raid and concurrently with the subsequent criminal proceedings against the persons arrested the campaign in the official Press, against the company was made more aggressive and violent. But throughout this campaign no charge of "espionage" or any other political activity was ever made against the company by the Government in the correspondence, or in the many interviews between the chief representatives of Lena and the leading members and officials of the Government.

The natural result of this campaign, culminating in the raid and prosecution, was that the staff of Lena, including the whole of its labour, was terrorized.

A local raid of the same kind was carried out at Sverdlovsk on February 4, 1930, when 14 persons were similarly searched.

The criminal trial took place after the arbitration proceedings had begun, and it is not necessary for the Court to discuss it or the constitutional relationship in Soviet law between the Executive and the Judiciary, and between executive policy and justice, save to observe that it

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rests on principles fundamentally different to those of the rest of the Western world. The effects of this relationship were particularly apparent in the evidence before the Court in regard to "Labour Courts" in the Lenskoie area in connexion with gold thefts and with trade union questions. So far as Lena's employees are concerned there was nothing in the evidence before the Court to suggest that they had been guilty of any "espionage" or other disloyalty to the Government.

(i) During the autumn of 1929 and the winter of 1929-30 old difficulties of Lena were aggravated and many new ones arose, partly in connexion with trade union claims, partly in connexion with the furnishing of supplies-e.g. cereals for men and horses-causing grave troubles in regard to labour and transport. For these the conduct of the Government was responsible.

The result of the actions of the Government described in sub-paragraphs.

(a) to (i) above was to deprive the company of available cash resources, to destroy its credit, and generally to paralyse its activities.

22. Before drawing final conclusions upon the above-mentioned facts it is desirable to state the legal form in which Lena's claim was presented to the Court. It was admitted by Dr. Idelson, counsel for Lena, that on all domestic matters in the U.S.S.R. the laws of Soviet Russia applied except in so far as they were excluded by the contract, and accordingly that in regard to performances of the contract by both parties inside the U.S.S.R. Russian law was "the proper law of the contract," i.e., the law by reference to which the contract should be interpreted.

But it was submitted by him that for other purposes the general principles of law such as those recognized by Article 38 of the Statute of the Permanent Court of International Justice at The Hague should be regarded as "the proper law of the contract" and in support of this submission counsel for Lena pointed out that both the Concession Agreement itself and also the agreement of June, 1927, whereby the coal mines were handed over, were signed not only on behalf of the Executive Government of Russia generally but by the Acting Commissary for Foreign Affairs, and that many of the terms of the contract contemplated the application of international rather than merely national principles of law. In so far as any difference of interpretation might result the Court holds that this contention is correct.

23. The company's claim was put thus. Lena made no claim for damages for any breaches of contract down to the time of the final claim, although it relied on them as part of the history of the case and as an answer to various claims of the Government. Its main claim it put in two alternative ways, preferably the second.

The first was for damages for breach of contract—viz., the present value of the future profits lost by reason of the Government's acts and defaults. The second was for restitution to the company of the full present value of the company's properties, by which in the result the Government had become "unjustly enriched." This second formulation of the case rested upon the principle of Continental law, including that of Soviet Russia, which gives a right of action for what in French law is called "Enrichissement sans cause"; it arises where the defendant has in his possession money or money's worth of the plaintiff's to which he has no just right.

This right is recognized and enforced in Germany under Article 812 of the Civil Code. It is also recognized in Scottish law, but not fully in English law; although the English right of action "for money had and received" on "total failure of consideration" often leads to the same result. The principle was discussed and approved in the British House of Lords in the Scotch case of *Cantiare San Rocco S.A. v. Clyde Shipbuilding Company, Limited*, 1924 Appeal Cases, p. 226.

Counsel for Lena contended that the Government was, in fact, in possession, present and future, throughout the remainder of the Concession (25 years for Lenskoi and 45 years for the rest) of Lena's valuable properties, into which Lena had put £3,500,000 sterling, and from which Lena was entitled, if the Government had performed its contract, to great profits; and that, as the Government had wrongfully turned the company out of Russia, it obviously could show no "just cause for its enrichment."

24. It follows that, as the question of "just cause" is in issue, it is material to consider the

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character of the Government's conduct in doing what the Court decides that it did. On that question the following facts are relevant:

(a) In the raid on December 15, 1929, a large number of documents throwing light on the best methods of working the difficult metallurgical processes and ore dressing, upon a knowledge of which the successful exploitation of the company's enterprises by anyone else would depend, were taken away by the Government. It is immaterial whether the documents were permanently retained or returned after a certain delay.

(b) At this time the company's greatest schemes of development of mines, flotation plants, metal extraction, furnaces, etc. covering vast areas of ground at Sverdlovsk alone 21 acres were nearly completed, and everything practically in working order except for the final ascertainment of the best method of dealing with the zinc concentrates in the Altai.

(c) As Lena's counsel pointed out, these steps so taken by the Government were such as to promote the Five-Year Plan.

25. The Court finds as a fact that this state of affairs in which Lena found itself in February, 1930, brought about (in the words of Lena's telegram demanding arbitration) a "total impossibility for Lena of either performing the Concession Agreement or enjoying its benefits."

The Court further decides that the conduct of the Government was a breach of the contract going to the root of it. In consequence Lena is entitled to be relieved from the burden of further obligations thereunder and to be compensated in money for the value of the benefits of which it had been wrongfully deprived. On ordinary legal principles this constitutes a right of action for damages, but the Court prefers to base its award on the principle of "unjust enrichment," although in its opinion the money result is the same.

26. It remains to consider the amount which on either basis ought to be paid. The problem before the Court is to arrive at the present value, if paid in cash now, of future profits which the company would have made and which the Government now can make on the assumption of good commercial management and the best technical skill and up-to-date development. In the case of Lena that assumption has been fully proved by past facts. In the case of the Government it is legally just.

The problem is, therefore, similar to that of ascertaining a fair purchase price for a going concern. The principles of such valuations are to-day, well known, as the result of accumulated experience in the estimating of mineral properties all over the world. In Article 84 of the Concession Agreement, which deals with optional redemption by the Government on the expiration of 35 years, it is expressly provided that the purchase price is to be "determined by multiplying the average annual income by the number of years remaining to the end of the concession, with discount of incomes intended to be paid in advance" (i.e., under the redemption) "of 5 per cent. per annum," and that "on calculating the income Lena is bound to be guided by the methods generally adopted in large mining and metallurgical enterprises of England and the U.S.A." These methods the Court has followed in its calculations.

*[The award then explains at length the "primary factors" of the method of calculation and then, in paragraph 27, gives the figures arrived at. This part of the award is omitted in The Times, which reproduces only the following totals:]*

Lenskoie	
Gold .....	£985,000
Urals	
Copper .....	£1,900,000
Iron .....	£7,000,000
Altai	
Copper, lead, zinc, silver, gold .....	<u>£3,080,000</u>
<b>Total sum awarded .....</b>	<b>£12,965,000</b>

The Court directs the Government to pay to Lena the above sum of twelve millions nine hundred sixty-five thousand pound sterling.

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28. In the course of the hearing it was admitted by Lena that the Government had lent the company some 4,500,000 roubles, and that the company was, down to September 30, 1929, behindhand to the extent of 644,000 roubles in its payment of royalties, and that the Government was claiming a further 147,000 roubles as royalty on the portion of the price paid for gold represented by certain "premium" additions which had been made in response to Lena's complaint that it was not getting English sterling or its equivalent as due under Article 81.

Evidence was given on behalf of Lena of an understanding that repayment of the loan was not to be demanded because of the non-payment by the Government of the price of the gold in sterling, and that the shorts on the royalties were only to be paid on receipt by Lena on October 1, 1929, of 25 per cent. advance payment for the ensuing year's gold output.

Without deciding whether these understandings ever became binding agreements, we are of opinion that the Government's claim to these moneys must be subject to a defense by way of set-off of the short payment of the gold price (see paragraph 21 (a) above). As this was not less than £1,000,000 judgment must be given for Lena on these two claims by the Government.

29. Lena, as above stated, put forward an alternative claim. This was for restitution of the money spent by the company: (a) On prospecting, development, and equipment; (b) on costs incidental to obtaining the concession; and (c) on the acquisition of shares of the old companies, (d) interest. The total amount so spent was about £8,500,000 sterling. Of this amount (a) represented about £3,500,000, and (c) about £4,500,000. It was contended that restitution was due on the principle of "unjust enrichment," and in regard to (c) reliance was placed on the terms of the special agreement contained in Schedule 3 of the Concession, whereby Lena guaranteed the Government against claims by the old companies mentioned in that schedule, which were expropriated in 1918-19, when the Government nationalized private mineral properties, or by their shareholders.

Head (c) would have been open to considerable doubt, but the Court would have allowed (a) if it had not been covered by the main claim, in respect of which the Court decides in favour of Lena.

30. If the Government should think that the Court's conclusions on the facts would have been different if the Government's witnesses had been before the Court, the Court regrets their non-attendance at its sittings; but it is bound to observe that nobody but the Government itself is to blame for any such incompleteness in the evidence. In truth, however, so much of the essential evidence, upon which the Court's conclusions depend, was contained in written documents of a contemporaneous character, and the oral evidence of the company's witnesses was corroborated to so large an extent by documents or admitted facts, that the Court feels sure that its conclusions would not have been in any material degree modified in favour of the Government by any evidence the Government could have called.

31. The Court directs that all moneys due shall be paid in British sterling, and shall carry interest at 12 per cent., pursuant to the terms of Article 82 of the Concession Agreement, from the date of this award.

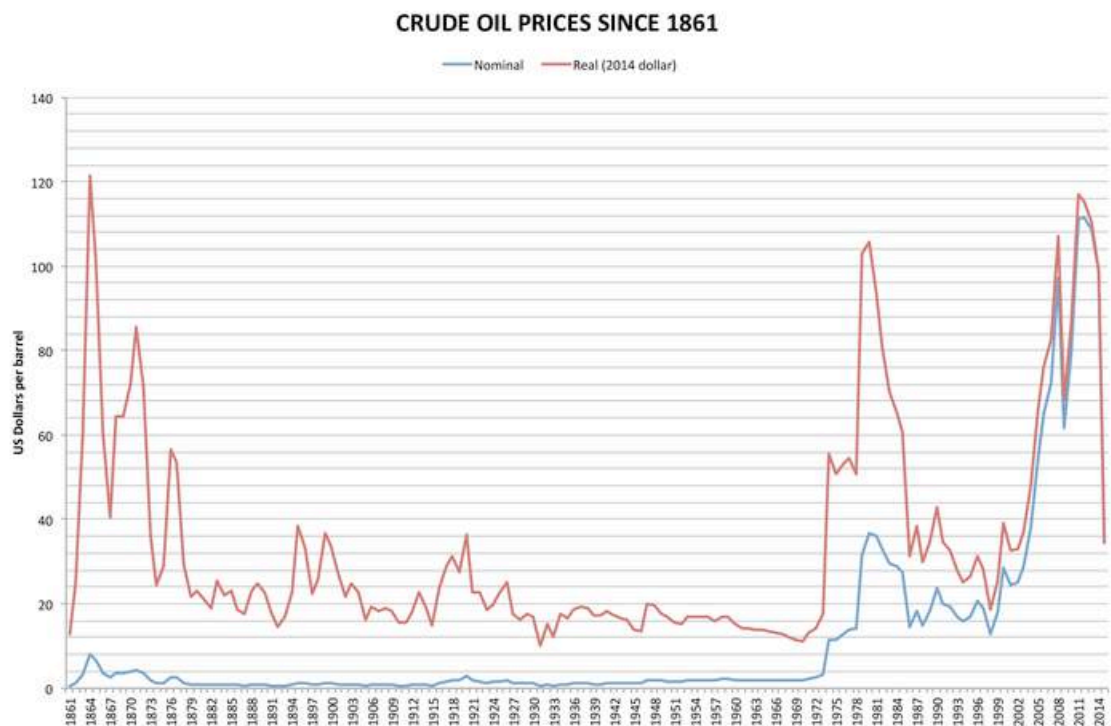
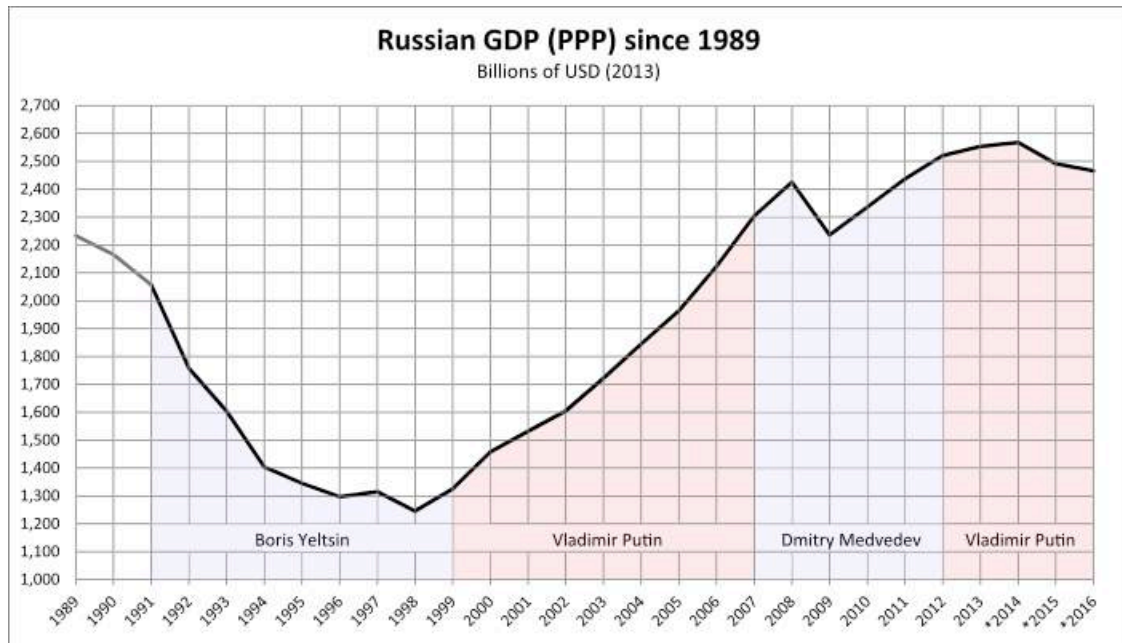
32. The Government is directed to repay to Lena one-half of the expenses for the chairman and the secretariat on production of the chairman's receipt for the payment of the total amount due therefor.

33. The Court resolves that the Concession Agreement is dissolved.

(Signed)

O. STUTZER.  
LESLIE SCOTT.

## Annex 8. Russian GDP from 1989 to 2016 and crude oil price from 1861 to 2014<sup>619</sup>



<sup>619</sup> Heycci, *GDP of Russia since 1989*; Jashuah, *Crude oil prices since 1861*



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**Annex 9.** Logo of OJSC Yukos Oil Company

