Appendix 1

Arbitration case
Mr. Franz Sedelmayer v. The Russian Federation
through the Procurement Department of
the President of the Russian Federation

Dissenting Opinion of Arbitrator Prof. Ivan S. Zykin

1. Is the Claimant an Investor under the 1989 Investment Treaty?

One of the major issues here is whether the Claimant may enjoy the protection under the Treaty with respect to investments made by SGC International, a legal entity incorporated in the U.S.A.. The Claimant maintains that such protection should be granted as he *de facto* controls this entity, and the control theory leads to the piercing of SGC International's corporate veil and to putting the *de facto* investor, i.e., the Claimant, in the focus.

It may be noted in general that the meaning attributed to the so-called "control theory" may be different in various instances and this circumstance should be taken into account when a reference to this theory is made.

In support of his position that the "control theory" is widely recognized, the Claimant referred, in particular, to the decision rendered in the ELSI case by a chamber of the International Court of Justice in 1989 and to a number of publications on the subject. Most of this evidence deals with a diplomatic protection of company members by the relevant state. The Claimant is not a state in our case, but a private person. The presented publications also discuss the problem in general without paying attention to corresponding approaches existing in Russia and Germany.

Since the claim is based on the 1989 bilateral Investment Treaty between these two countries, its provisions are of decisive importance. The real question is not whether the "control theory" in its various meanings is known in international public law, national laws and legal doctrine, the question is whether it is accepted in the 1989 Treaty in the sense attributed to this theory by the Claimant.

Item 3 of the Protocol to the 1989 Treaty envisages that an investor of one Contracting State may be entitled to compensation if the other Contracting State interferes with the economic activities of an enterprise in which he is

Even if some parallel may be drawn between the ELSI case and the underlying idea of item 3 of the Protocol to the 1989 Treaty, the factual situation in the present case is quite different.

In this case the Russian participant in the joint venture KOC established in Russia contributed certain premises belonging to the Russian State as his share in the capital. This contribution was made without proper authorization required under the Russian legislation. Afterwards, Russian authorities took some measures (including court decisions) in order to remedy the situation and return the premises to its legal owner. That was primarily the aim as correctly follows from the Award. The Premises were not the Claimant's investments and the measures related to KOC in the first run.

Under item 3 of the Protocol to the 1989 Treaty, the interference with the economic activity of a joint venture may, under certain conditions, give ground to a participant of such joint venture to claim compensation. This provision of the Treaty aims at protecting the rights of investors in the sense of the Treaty. It could not, in our view, be regarded as an acknowledgment of the rights of the so-called "*de facto* investor". Such term is not used in the Treaty, and the concept of "*de facto* investor", which seems rather ambiguous in itself, is not accepted in the Treaty.

Item 3 of the Protocol clearly states that an investor may be entitled to compensation with respect to his investment to an enterprise in which he is participating. It does not matter whether the investor controls this enterprise or not.

The Claimant is not a participant of KOC. In our case, the participant involved is SGC International, an American company. The Award correctly states that "in the present case the nationality of SGC International ... is not in issue. Mr Sedelmayer has admitted that SGC International shall be regarded as an American company ... Consequently, Mr. Sedelmayer has not alleged that SGC International is an investor under the Treaty and he has not put forward his claims on behalf of SGC International. Instead, he is claiming compensation as a natural person."

The real issue is then whether Mr. Sedelmayer as a natural person could seek protection under the Treaty between Russian and Germany, in connection with the investments made by the American company under his control in the joint venture established in Russia.

to bring a suit in such a case is recognized by the Treaty or not, i.e., whether the Claimant is proper.

We share the observation made by professor M.M. Boguslavskii in his legal opinion of April 1997 that the use of the control criterion when the legal personality of a juridical person is actually disregarded is exceptional in international practice and this criterion is always applied for special (and, we could say, rather limited) purposes.

The use of the control criterion may lead to considerable practical difficulties. When a testimony of professor Ove Bring was heard before the Tribunal, the Chairman asked him, among others, two questions which are relevant here. If under the Investment Treaty between Russia and the U.S.A. an American company claims a compensation and under the 1989 Treaty between Russia and Germany a natural person controlling this company also files a claim for compensation of the same allegedly sustained losses, what the solution is. The answer was that a choice should be made. Consequently, in the opinion of professor Ove Bring, only one claim could be satisfied. It remained unclear, however, in whose favour and how this choice should be made.

The next question dealt with another hypothetical situation where a German company made investments in Russia and this company is totally controlled by a natural person, a German resident. The question was who could claim compensation under the 1989 Treaty in an appropriate case. In the opinion of professor Ove Bring, both the company and the natural person could claim. Here again is unclear who is entitled to compensation. Surely, this compensation could not be awarded twice.

Similar difficulty arises when an investor (a company) files a claim with a local court of the relevant state for compensation in an attempt to remedy a situation created by measures taken by that state, and a person who controls this company resorts to international arbitration under the Treaty. What if a company has several participants and none of them taken separately could control it; should they then be deprived of protection because of that? The above examples are not exhaustive.

The use of the control criterion is definitely not a mere technicality with a limited practical significance. Conclusion of investment treaties between different states has a long history. some countries use this criterion in their

The 1989 Treaty between Russia and Germany is not an exception in this respect. This view is clearly supported in a number of publications written in Russia and Germany prior to these proceedings and dealing with the Treaty (see, in particular, Professor Dr. jur. C.-Th. Ebenroth, Dr. jur. B. Bippus Der deutsch-sowietische Investitionsschutzvertrag. - Recht der Internationalen Wirtschaft. - Beilage 5 zu Heft 7/1989. - S. 6, 11; Professor M.M. Boguslavskii "Foreign Investments. Legal Treatment." Moscow, 1996. - P. 67-68 (in Russian); Dr. N.I. Marysheva "On the Legal Status of Foreign Investors." - Soviet Journal of International Law. - 1991. - No. 3-4. - P. 38-40 (in Russian); Dr. I.O. Khlestova. Legislation and International Treaties on Protection of Foreign Investments. - Moscow Journal of International Law. - 1992. - No. 2. - P. 102-103 (in Russian)).

Under the circumstances, it is of great importance to properly take into account how the provisions of the Treaty are understood in the signatory states. The relevant available materials show that the control criterion is not accepted in the Treaty even implicitly. No evidence is presented to the effect that these provisions are understood in the opposite meaning in Russia or Germany.

The Claimant could have made investments personally or through a German company, but, instead, he preferred to act, as explained, for tax reasons through a company of a third state. It seems unlikely that the purpose of the 1989 Treaty between Russia and Germany was to encourage such kind of investments and to offer them protection. Figuratively speaking, encouragement and protection here are two sides of a coin. The application of the control criterion in such a situation would mean that the contracting states are placed under obligations which they have not assumed in accordance with the 1989 Treaty.

The fact that the bilateral investment protection treaty between Russia and the U.S.A. has not yet entered into force could not serve either, in our opinion, as a ground for unjustified widening of the scope of application of another bilateral international treaty.

As to the investments allegedly made by the Claimant personally, the presented evidence is not sufficient, in our view, to come to a conclusion that such investments satisfying the requirements of the Treaty were made.

2. <u>The proper Respondent</u>

It was at the initial stage that the Procurement Department notified by the letter of March 20, 1996 that it could not be regarded as a contracting party under the 1989 Treaty between Russia and Germany. The Procurement Department repeatedly stated this position in its letters of April 15 and May 27, 1996, and in subsequent submissions.

Nevertheless, in the document of May 3, 1996 entitled "Addition to the Request for Arbitration", the Claimant again indicated the Procurement Department as a Respondent.

In two letters of June 28, 1996 informing of the appointment by the Claimant of legal counsel and a new arbitrator, the Claimant used the heading "Franz Sedelmayer./.the Russian Federation". Referring, however, to the above-mentioned letter of the Procurement Department dated March 20, 1996, the Claimant qualified it as "Respondent's correspondence" and maintained that the Respondent could not state that this entity of the Russian Federation was not a "party" to the 1989 Treaty. A similar heading was used in the request to appoint the presiding arbitrator addressed by the Claimant to the President of the Arbitration Institute of the Stockholm Chamber of Commerce (letter of August 22, 1996).

In the document of September 3, 1996, whereby such appointment was made, the name of the Respondent was indicated as "Presidential Administration, Procurement Department, a Government Entity of the Russian Federation", i.e., in conformity with the Request for Arbitration.

In the Statement of Claim of November 11, 1996 the following is written under the heading "Respondent": "The Russian Federation through its Presidential Administration, Procurement Department". The Claimant explained his position in detail on the issue in question in its submission dated May 30, 1997.

It also appears that all correspondence in this case was delivered to the address of the Procurement Department.

For the sake of clarity, it is worth noting that the Presidential Administration and the Procurement Department are different bodies and the former is not involved in the proceedings. These facts seem to be undisputed between the parties.

The confusion has arisen concerning the proper Respondent and as to

dated April 1997, dealing in particular with the same issue. In our view, these comments were made without undue delay.

It is well known that arbitration proceedings have their own, very important specific features as compared to court proceedings. Some procedural irregularities appear to have taken place, as far as the issue in question is concerned, from the point of view of the arbitration procedure in particular.

As follows from the Statute of the Procurement Department (approved by Decree of the President of the Russian Federation of August 2, 1995, No. 797), this Department is not legally identical to the Russian Federation. This conclusion is also supported by the legal opinion of professor M.M. Boguslavskii, dated April 1997. The main function of the Procurement Department is to render financial, logistical and social support to different state bodies and their staff. The powers and duties of the Procurement Department are in no way linked with negotiation of international investment treaties or ensurance of their application. By its status, the Procurement Department could not represent the Russian state in such proceedings.

This conclusion is not prejudiced by the fact that the Procurement Department was among the participants in local court proceedings related to KOC. These international arbitration proceedings under the 1989 Treaty and internal proceedings in a Russian court are based on entirely different legal grounds; the proper parties in these proceedings are not the same either. In our opinion, the involvement of the Procurement Department in the events that occurred prior to the initiation of the arbitration proceedings could serve no basis for determination who is the proper Respondent and whether the Procurement Department is representing the Russian Federation. A possible misunderstanding by the Claimant of these points, when initiating the arbitration proceedings, should not adversely affect the rights of the opposite party, whatever that party is.

The powers of attorney submitted by the representatives of the Procurement Department, who participated in the preparatory arbitration meeting and in the final hearing, authorize them to represent this Department. An oral declaration to that effect was also made by the said representatives who stressed that they represented only the Procurement Department, but neither the Russian Federation nor its President.

In the present case, the arbitration proceedings, in our opinion, were initiated against the improper party — the Procurement Department

Procurement Department as if there were taken in the name and on behalf of the Russian Federation. However, it did not happen.

Obviously, a party initiating arbitration may decide whom to name as a respondent. However, the party substitution could not take place automatically only because the claiming party so wished. The procedural rights of other parties concerned should be safeguarded and a state is not an exception in this respect, if it is such a party. The fundamental right of a party to be offered a possibility to choose an arbitrator is one of these rights. The Russian Federation could not be deprived of such right either.

A proper party, in our view, could not be substituted for an improper party by sending the suit to the initial improper party with an allegation that the latter represented and is representing the new proper party.

It is either not to the opposite party but to the state concerned that the sovereign right to choose its proper representative in the arbitration proceedings belongs.

It is difficult to ignore the impression that in addition to the notion of the "*de facto* investor" an attempt is made to introduce implicitly the notion of, so to say, a "*de facto* Respondent", which is unacceptable.

In the light of the above, the following conclusions could be made. The arbitration proceedings have been initiated against the improper Respondent. The Procurement Department does not represent the Russian Federation in these proceedings. The Russian Federation could not be regarded as having properly entered the proceedings.

* * *

The foregoing considerations allow, in our view, to conclude that the Tribunal lacks competence to try the case on its merits under the provisions of the 1989 Treaty. Consequently, there is no need to deal with some further issues in this opinion.