

MEMORANDUM OF DETERMINATION
Expropriation Claim of Global Forestry Management Group (Russia)
OPIC Contract of Insurance No. F339

I. CLAIM

On March 24, 2010, Global Forestry Management Group (the “Investor” or “GFMG”) submitted a claim (the “Claim”) to OPIC for compensation under the expropriation coverage of OPIC Contract of Insurance No. F339 (the “OPIC Contract”). The Investor’s active coverage under the OPIC Contract was for up to US\$1,167,698. The OPIC Contract covered the Investor’s investment in Open Joint Stock Company Terminal, a Russian open joint stock company (“Terminal”), and in Joint Venture SovGavan Port, a Russian limited liability partnership (“SGP”).

This memorandum of determinations solely addresses the issue of whether the Investor is entitled to compensation under the OPIC Contract with respect to its investment in SGP alone. The Investor claims that its investment in SGP was effectively expropriated by the Government of Russia (“GOR”) by its failure to afford the Investor the protection and security required under international law. OPIC has determined that the Claim is valid based on its review of materials and statements provided by the Investor and that the amount of compensation due under the OPIC Contract is \$1,034,574.

II. FACTUAL SUMMARY

GFMG has a 70% partnership interest in SGP. Since February 1, 1995, SGP has had exclusive operating rights at a 10 hectare port facility (the “Facility”) at the port of Sovgavan, located in the Khabarovsk Krai region of the Russian Far East.¹ SGP leased operating rights to the Facility from Terminal and ran all operations at the Facility utilizing its own personnel and equipment.² SGP’s business was to handle the export of timber products from the Facility.³

GFMG initially invested approximately \$1 million in fixed assets, equipment and working capital in order to commence SGP’s operations, and between 1994 and 2007 most of its earnings were re-invested to improve the Facility’s infrastructure (e.g., adding rail spurs, paving storage areas, improving the Facility’s electrical supply, adding buildings). As the volume of cargo shipped through the Facility increased, approximately \$1.5 million of additional operating equipment (e.g., cranes, front-end wheeled loaders, hydraulic log loaders) was added, most of which was either financed by or leased from GFMG.

¹ The current operative lease agreement is dated June 20, 2000 and provides for a lease term of 20 years.

² In 2000, GFMG acquired 36% of Terminal’s publicly traded stock.

³ The Facility, as an active international port, was both a licensed Russian Customs Regime Zone and an approved facility under the Russian Maritime Security Services regulation.

For several years before the events that led immediately to the Claim, SGP had difficult relations with Terminal. In 2006 and 2007, Terminal filed two separate legal actions in an attempt to collect higher lease payments and to declare the lease non-binding. Both claims were rejected by the courts. In December 2007, a large customer of SGP, who was also the majority owner of Terminal, stopped paying SGP directly for its port handling services. Instead, it made payments to Terminal, which then credited the funds it received against what Terminal claimed were SGP's debts for past due lease payments to Terminal.⁴ Without these payments, SGP did not have the funds to make timely wage payments to its workers.

In the beginning of 2008, SGP experienced a difficult financial situation caused by winter conditions that restricted the shipment of logs from the Facility. In February 2008, a meeting was held at the Facility that was organized by the mayor of the region and attended by Terminal, GFMG, SGP and SGP customers. At this meeting, Terminal argued that it should be allowed to take back the Facility from SGP, and it received no support for this position.

On March 1, 2008, Terminal brought its own security service onto the Facility and SGP's security service resigned. Per Russian federal requirements, the Facility is surrounded by a fence and, with the change in security services, Terminal took over all access into the Facility (the "Takeover"). Instead of availing itself of legally sanctioned methods of dispute resolution, Terminal arbitrarily seized the property and leasehold interests of SGP. No court or any other legal procedure was involved in this Takeover process.⁵

Terminal began operating the Facility itself using SGP's fixed assets and operating equipment. The Facility's locks were changed and proceeds from SGP's work-in-progress (effectively SGP's accumulated accounts receivables) were diverted to Terminal's bank account. On April 1, 2008, approximately 90 employees of the port resigned and went to work for Terminal. At the time of the Takeover, there was 48,262 cubic meters of timber products at the Facility that had been received by SGP for subsequent shipment. If Terminal had not taken over the Facility, SGP would have collected approximately nine million Rubles as this cargo was shipped. Instead, Terminal collected all of these proceeds.⁶ If SGP had been able to collect these proceeds, its debts to Terminal could have been satisfied.

⁴ In a ruling dated March 5, 2008 (after the Takeover), the Arbitration Court of Khabarovsk Territory ruled that SGP had a debt to Terminal in the form of back lease payments equal to Rubles 2,178,829 (case # A 73-12324/2007-4).

⁵ On April 8, 2008 (over a month after the Takeover), enforcement procedures were initiated to collect Rubles 2,201,324.09 from SGP.

⁶ Of the amount collected by Terminal, 751,000 Rubles were transferred to SGP bank accounts. SGP asserts that these transfers were made based on false invoices which Terminal had created as a ruse by Terminal to verify, through the payment of funds, that there was a pre-existing agreement between the two companies and therefore justify its actions during the Takeover.

As Terminal lacked the authority or legal status necessary to legally operate the Facility, Terminal also stole SGP's official stamps and, by forging SGP's signature authority, utilized them to illegally operate under SGP's permits, licenses and contracts. Terminal did not have any of the necessary permits or licenses to operate the Facility; however, despite SGP's objections, the relevant authorities did nothing to prevent Terminal from using SGP's permits and licenses.

For the sixteen months following the Takeover, Terminal continued operations at the Facility utilizing SGP's equipment to handle most of the material. In the process, most of SGP's equipment was consumed or destroyed.

Following the Takeover, GFMG, as 70% owner of SGP, immediately sought intervention from the Russian police, court and local government authorities, but no action was taken against Terminal during the illegal occupation period. The Chairman of the Board of SGP filed a request to open a criminal case against Terminal's executives for committing a crime specified in Article 330 of the Criminal Code of Russian (arbitrary action). On five separate occasions, the relevant local police department⁷ issued resolutions denying the opening of a criminal case against Terminal's executives. Each time the police refused to open a criminal case, the prosecutor for the Vanino Transportation office revoked the police resolution and ordered them to re-open the investigation based upon the incomplete nature of the investigation that the police had conducted.

In addition to the police, Russian customs and the Russian Maritime Security Services were also notified but provided no assistance. Since the Takeover, the U.S. Consul General in Vladivostok has been actively involved, but these official efforts have not resulted in any GOR action to resolve the situation. In February 2010, GFMG filed a complaint with the Minister of Internal Affairs but has not received any response.

Because of the Takeover, Terminal deprived SGP of the possibility of earning revenue, some of which could have been used to pay accumulated debts (including those to Terminal). Having deprived SGP of the ability to earn any revenue, in July 2008 Terminal petitioned the Khabarovsk Territory Arbitration Court for the bankruptcy of SGP. Under a ruling of the Khabarovsk Territory Arbitration Court dated February 17, 2009, SGP was declared bankrupt.

In early 2009, a court-appointed bankruptcy trustee took over the management of SGP and eventually sold its remaining assets. The bankruptcy trustee, who was nominated by Terminal, avoided filing a civil damages claim against Terminal for the assets taken by Terminal. On July 13, 2010, the Khabarovsk Regional court ruled that the SGP bankruptcy process was completed and that SGP should be dissolved. Subsequently, GFMG appealed the decision to the Far Eastern District Court, which has not yet rendered a decision.

⁷ The economic crimes prevention group of the Vanino Transport Police Department.

As a result of governmental inaction, the Investor claims that its interest in SGP has been effectively expropriated.⁸

III. DETERMINATIONS UNDER THE OPIC CONTRACT

A. The actions taken by the GOR with respect to GFMG insured investment in SGP constitute total expropriation within the meaning of Section 4.01 of the OPIC Contract.

Four issues are presented by Section 4.01 of the OPIC Contract, which sets forth the requirements for total expropriation coverage: (1) whether the acts were attributable to a foreign governing authority; (2) whether the acts constituted (i) an outright taking of the Investor's property or (ii) have the effect of taking Investor's insured investment in that the acts prevent, unreasonably interfere with, deprive, or unduly delay effective enjoyment of the Investor's fundamental rights in the insured investment; (3) whether the taking is accompanied by prompt, adequate and effective compensation and (4) whether the expropriatory effect has continued for the requisite six-month period.

1. The acts are attributable to a foreign governing authority.

The identity of the foreign governing authority in control of Khabarovsk, Russia is not in question in this case. The OPIC Contract defines "foreign governing authority" as "(a) the central government of the project country; (b) the government of any political subdivision of the project country; and (c) any organ, agency, official, employee or other agent or instrumentality of either (a) or (b), acting within the scope of its authority or under color of such authority; provided, however, that in each case such governmental authority is in de facto control of that portion of the project country in which the project is located." The GOR is in effective control of all of Russia.

2. The acts of the foreign governing authority have the effect of taking Investor's insured investment in that the acts prevent, unreasonably interfere with, deprive, or unduly delay effective enjoyment of the Investor's fundamental rights in the insured investment.

⁸ As stated above, this Memorandum of Determination only addresses the Takeover of SGP. The following facts are included for information only to understand the eventual ownership of the Facility. The Investor owns 36% of Terminal. The Amur Shipping Company, whose majority shareholder is the Russian Forest Products Group (the "RFP Group"), petitioned to have Terminal declared bankrupt. The RFP Group also owns over 50% of Terminal. On July 20, 2010, Terminal was declared bankrupt by a bankruptcy court, and a court-appointed trustee took over the management of its remaining assets. In July 2010 (prior to the bankruptcy), the Amur Shipping Company (25.5% of which is owned by the Russian government) acquired the Facility and is rebuilding it into a coal export terminal. For a general discussion of the topic of corporate raiding in Russia, see Thomas Firestone, *Criminal Corporate Raiding in Russia*, 42 Int'l Law. 4, 1207-29 (Winter 2008).

Article IV of the OPIC Contract comports with customary international law in its recognition of both direct and indirect expropriation. Direct expropriation, or “outright taking,”⁹ generally involves a transfer of legal title and a forced abandonment of the investor’s physical assets.¹⁰ By contrast, indirect expropriation entails government action that leaves an investor’s title untouched but nonetheless deprives the investor of “the possibility to utilize the investment in a meaningful way.”¹¹ The OPIC Contract refers to indirect expropriation as government actions that “prevent, unreasonably interfere with, deprive, or unduly delay effective enjoyment of the Investor’s fundamental rights in the insured investment.”¹² Notably, this formulation echoes those of the Harvard Draft Convention on the International Responsibility of States for Injuries to Aliens¹³ and the Third Restatement of Foreign Relations of the United States.¹⁴

The concept of intent versus effect has also informed expropriation determinations under international investment law. In direct expropriations, a government’s outright seizure of a private investor’s legal title and physical assets betrays an obvious intent to take the private property.¹⁵ Confronted with allegations of indirect expropriations, however, tribunals have generally applied a “sole effect” doctrine, which primarily examines the effect of a government’s actions.¹⁶ For example, the Iran-U.S. Claims Tribunal found a taking in Iran’s deprivation of fundamental property or contract rights of several American companies notwithstanding the lack of a formal decree of nationalization.¹⁷ The Tribunal explained:

. . . it is recognized in international law that measures taken by a State can interfere with property rights to such an extent that these rights are rendered so useless that they must be deemed to have been expropriated, even though the State does not purport to have

⁹ OPIC Contract § 4.01(a)(i).

¹⁰ RUDOLPH DOLZER & CHRISTOPH SCHREUER, *PRINCIPLES OF INTERNATIONAL INVESTMENT LAW* 92 (2008); George C. Christie, *What Constitutes a Taking Under International Law?*, 28 BRIT. Y.B. INT’L L. 307, 309 (1962).

¹¹ DOLZER & SCHREUER, *supra* note 7, at 92; *see also* Christie, *supra* note 7, at 309 (“[I]nterference with an alien’s property may amount to expropriation even when no explicit attempt is made to affect the legal title to the property.”).

¹² OPIC Contract § 4.01(a)(ii).

¹³ LOUIS B. SOHN & RICHARD BAXTER, *CONVENTION ON THE INTERNATIONAL RESPONSIBILITY OF STATES FOR INJURIES TO ALIENS: DRAFT, ISSUE 12* 104 (Cambridge, Harvard Law School 1961) (defining a taking as any “unreasonable interference with the use, enjoyment or disposal of property as to justify an inference that the owner thereof will not be able to use, enjoy, or dispose of the property within a reasonable time after the inception of such interference”).

¹⁴ RESTATEMENT (THIRD) FOREIGN RELATIONS LAW OF THE UNITED STATES § 712, cmt. g (1987) (finding state responsibility for a state action that “prevents, unreasonably interferes with, or unduly delays, effective enjoyment of an alien’s property”).

¹⁵ *See, e.g., Texaco Overseas Petroleum Co. and California Asiatic Oil Co. v. Government of the Libyan Arab Republic*, 53 ILR 389 (1977); *AMOCO International Finance Corp. v. Government of Islamic Republic of Iran*, 15 Iran-US Cl. Trib. Rep. 189 (1987).

¹⁶ *See* DOLZER & SCHREUER, *supra* note 7, at 101-104.

¹⁷ *Starrett Housing v. Islamic Republic of Iran*, 4 Iran-US CTR 122 (1983).

expropriated them and the legal title to the property formally remains with the original owner.¹⁸

Thus, the OPIC Contract reflects a body of international investment law that recognizes the expropriatory effects of state actions that prevent, unreasonably interfere with, deprive, or unduly delay effective enjoyment of an investor's fundamental rights in its investment.

The factual basis of GFMG's expropriation claim raises an unusual set of circumstances because it involves the GOR's *inaction* in addressing the forceful taking of GFMG's investment by *private* actors. GFMG appealed promptly and repeatedly to multiple GOR authorities, including Russian police, courts, local government authorities, customs officers and the Russian Maritime Security Services. Yet, for over two years, none of those authorities took any action to remedy the situation or to enforce the GOR's own commercial, tort, or criminal laws.

GFMG has raised several hypotheses regarding the possible self interests that the GOR may have served through its inaction. However, consistent with the indirect expropriation jurisprudence discussed above, OPIC will not consider the GOR's possible intentions. Rather, the decisive inquiry is whether the GOR's *inaction* is so severe as to constitute an "action" that effectively deprived GFMG of its fundamental rights in SGP. For the reasons outlined below, OPIC finds that it does.

Though not entirely consistent,¹⁹ the balance of jurisprudence and scholarly writing indicates that state acts may consist of omissions. In its Draft Articles on Responsibility of States for Internationally Wrongful Acts, the U.N. International Law Commission includes omissions by a state as a potentially wrongful act.²⁰ As explained in its accompanying Commentary, "[a]n internationally wrongful act of a state may consist in one or more actions or omissions or a combination of both."²¹ A fundamental denial of justice exemplifies a state

¹⁸ *Id.* at 154. See also *Jahangir Mohtadi v. Islamic Republic of Iran*, Iran Award 573-271-3, Case No. 271 (1996) ("It is firmly established in the Tribunal's jurisprudence that liability for interference with property rights may be found even where the formal legal title to property has not been affected."); *Tippets, Abbott, McCarthy, Stratton and TAMS-AFFA Consulting Engineers of Iran, et al.*, Award No. 141-7-2 (29 June 1984) ("A deprivation or taking of property may occur under international law through interference by a state in the use of that property or with the enjoyment of its benefits, even where legal title to the property is not affected.").

¹⁹ Compare, e.g., *Eureko B.V. v. Poland*, 12 ICSID Reports 335 (Partial Award 2005) (finding state inaction rising to the level of expropriation) with *Eurooro A Oguin v. Republic of Paraguay*, ICSID Case No. ARB/98/5 para. 84 (Award, 26 July 2001) ("Expropriation therefore requires a teleologically driven action for it to occur; omissions, however egregious they may be, are not sufficient for it to take place.").

²⁰ International Law Commission, *Report of the International Law Commission: Draft Articles on Responsibility of States for Internationally Wrongful Acts*, UN GAOR, 53rd Sess., YEARBOOK OF THE INTERNATIONAL LAW COMMISSION, 2001, vol. II, Part Two, art. 2.

²¹ *Id.* at art. 1, cmt. 1. Note that, although these draft articles have not been accepted by any state, they perform the function of restatements of customary international law in this area. OSCAR SCHACHTER, INTERNATIONAL LAW IN THEORY AND PRACTICE 69 (1991) ("Although ... in the form of conventions requiring ratification or accession, they have been widely accepted as generally declaratory of existing law and therefore actually given legal effect even

omission that invokes such state responsibility. Though customary international law does not require any state to admit foreign investment into its territory, a state that chooses to do so incurs an obligation to provide its foreign investors with a minimum standard of treatment.²²

This minimum standard incorporates a procedural obligation to provide a “civilized system of justice as reflected in accepted international and national practice.”²³ A state’s failure to accord such procedural due process invokes state responsibility for “denial of justice,” an event occurring “when there is a denial, unwarranted delay or obstruction of access to courts, gross deficiency in the administration of judicial or remedial process, failure to provide those guarantees which are generally considered indispensable to the proper administration of justice, or a manifestly unjust judgment.”²⁴ Thus when a local business partner forcibly assumed management of a joint venture with an American investor in *Amco Asia Corporation. v. Republic of Indonesia*, the reviewing arbitral tribunal found that “[e]xpropriation in international law also exists merely by the state withdrawing the protection of its courts from the owner expropriated, and tacitly allowing a *de facto* possessor to remain in possession of the thing seized, as did the Roman praetor in allowing *longi temporis praescripto*.”²⁵

Likewise, when the GOR accepted GFMG’s foreign investment, it also accepted an obligation to provide GFMG with the minimum due process standards of a civilized justice system. Yet when confronted with the outright seizure of GFMG’s assets, finances, licenses and permits, the GOR’s police, courts, municipal authorities, customs agents and security services all denied GFMG any judicial or administrative remedy. The GOR’s failure to address the taking of GFMG’s investment violated the minimum standards of treatment owed to GFMG under customary international law and effectively deprived GFMG of its fundamental rights in SGP.²⁶ In addition to losing the value of its physical assets, GFMF has lost the balance of its accounts,

prior to their formal entry into force . . . In this way, the old issue of ‘restatement’ versus convention was rendered academic since the conventions were in fact regarded and used as if they were restatements except where there was persuasive evidence that a particular provision was intended to be *de lege ferenda*.”)

²² See, e.g., DOLZER & SCHREUER, *supra* note 7, at 7; see also *Amco Asia Corp. v. Republic of Indonesia*, 1 ICSID Reports 413, 493 (Award 1993) (“Indeed, by receiving the authorization to invest, Amco was bestowed with acquired rights (to realize an investment, to operate it with a reasonable expectation to make a profit and to have the benefit of the incentives provided by law) . . . These acquired rights could not be withdrawn by the Republic, except by observing the legal requisites of procedural conditions established by law . . .”).

²³ See, e.g., DOLZER & SCHREUER, *supra* note 7, at 163.

²⁴ IAN BROWNLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 506-07 (2003) (citing Article 9 of the 1929 *Harvard draft Responsibility of States*, 23 AM. J. INT’L L., Spec. Suppl. 173 (1929)).

²⁵ *Amco Asia Corp. v. Republic of Indonesia*, ICSID Case No. ARB/81/1, Award, 20 Nov. 1984, ICSID Reports 413, 455 (1993). The term *longi temporis praescripto* was a Roman legal concept that title to property could be acquired through possession for a period of time; see REINHARD ZIMMERMANN, COMPARATIVE FOUNDATIONS OF A EUROPEAN LAW OF SET-OFF AND PRESCRIPTION 69-70 (2002).

²⁶ The United States and the Russia Federation executed a Treaty Concerning the Encouragement and Reciprocal Protection of Investment on June 17, 1992 (the “BIT”). The BIT has not been ratified by Russia and is therefore not in effect. We note, however, that the treaty provides that, “Investment shall at all times be accorded fair and equitable treatment, shall enjoy full protection and security, and shall in no case be accorded treatment inconsistent with the norms and principles of international law.” (Article II, Section 2(a)).

as well as the economic value of its licenses and permits. As such, the GOR's inaction constitutes an indirect expropriation covered under Section 4.01 of the OPIC Contract.

3. *The taking is not accompanied by prompt, adequate and effective compensation.*

The deprivation of property is a violation of international law if prompt, adequate, and effective compensation is not paid.²⁷ Although it has filed numerous claims and complaints against the GOR, GFMG has not succeeded in obtaining any compensation from other sources.

4. *The expropriatory effect continues for six consecutive months.*

To date, the GOR has not taken any action that would provide relief or compensation. Therefore, OPIC finds that the alleged violations of law have not been remedied and the alleged expropriatory effect has continued for the requisite six-month period.

B. Section 4.03 Exclusions, Section 5.03 Adjustments and 5.04 Limitations.

The duty to pay compensation by OPIC is subject to the exclusions, adjustments and limitations in Sections 4.03, 5.03 and 5.04 of the OPIC Contract. Neither of the exclusions in Section 4.03 of the OPIC Contract applies to this claim.

Under Section 5.04 of the OPIC Contract, compensation is limited to "the Active Amount on the date the expropriatory effect commences."²⁸ The Active Amount (as defined in the OPIC Contract) was \$1,167,698 for the entire term of the OPIC Contract. SGP's financial statements demonstrate a book value of \$1,477,963 as of December 31, 2007. The Investor's share in SGP was 70%, and thus the book value of the Investor's investment in SGP was \$1,034,574. Since the book value of the Investor's investment is less than the Active Amount, the Claim is not limited by the Active Amount.

Under Section 5.04 of the OPIC Contract, compensation is limited by "the maximum amount which could be received by the Investor from OPIC without breaching §9.01.3."²⁹ Section 9.01.3 provides that "the Investor shall continue to bear the risk of loss of at least 10% of the book value of its interest in the foreign enterprises." The combined book value of the Investor's investments in SGP and Terminal is \$1,340,176 (90% of which is \$1,206,158), and therefore, since the Active Amount was \$1,167,698, the Investor bears a loss of at least 10% of the book value of its interest in the foreign enterprises.

²⁷ See O'Connell, 2 *International Law* 776-77 (2d. ed. 1970)

²⁸ OPIC Contract § 5.04(a).

²⁹ OPIC Contract § 504(c).

C. Procedural Issues.

There are no procedural issues that require discussion in connection with this claim determination.

D. Investor's Duties.

SGP's financial statements were kept in accordance with Russian accounting standards. The OPIC Policy (§ 9.01(6)(b)) requires that SGP's financials be kept in accordance with "principles of accounting generally accepted in the United States" ("GAAP"). The Investor delivered to OPIC SGP's Russian financial statements as of December 31, 2007, converted into U.S. Dollars in accordance with GAAP and recalculated to make several GAAP adjustments. OPIC accepts these recalculated financial statements for purposes of its determination.

IV. CONCLUSION

For the foregoing reasons, OPIC concludes that the Investor has established its right to compensation under the OPIC Contract and is entitled to compensation in the amount of \$1,034,574.

OVERSEAS PRIVATE INVESTMENT CORPORATION

By: 

Elizabeth L. Littlefield
President and Chief Executive Officer

Date: April 1st, 2011