

**INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES**

IN THE ARBITRATION PROCEEDINGS BETWEEN

**ALPHA PROJEKTHOLDING GMBH**

**(CLAIMANT)**

**V.**

**UKRAINE**

**(RESPONDENT)**

**ICSID Case No. ARB/07/16**

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**AWARD**

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Arbitral Tribunal:

Hon. Davis R. Robinson, Chairman

Dr. Stanimir A. Alexandrov, Arbitrator

Dr. Yoram Turbowicz, Arbitrator

Date of Dispatch to the Parties: November 8, 2010

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## **I. Introduction**

1. This case was brought by Alpha Projektholding GmbH, an Austrian limited liability company (“Alpha” or the “Claimant”) with its registered place of business in Villach, Austria, against Ukraine (“Ukraine” or the “Respondent”) pursuant to the Agreement for the Promotion and Reciprocal Protection of Investments between the Republic of Austria and Ukraine (the “UABIT”) that was signed on November 8, 1996, and entered into force on December 1, 1997. Article 9 of the UABIT provides for dispute resolution by means of arbitration before the International Centre for Settlement of Investment Disputes (“ICSID” or the “Centre”). Austria became a party to the 1965 Convention on the Settlement of Investment Disputes (the “ICSID Convention”) on June 24, 1971, and Ukraine became a party on July 7, 2000.

2. Claimant asserts violations of Article 2 (Protection and Promotion of Investments), Article 3 (Treatment of Investments), Article 4 (Compensation for Expropriation), and Article 8 (Other Obligations) of the UABIT, as well as certain provisions of the Ukraine Foreign Investment Law (“FIL”), with respect to an alleged “joint activity” for the renovation and operation of the Hotel Dnipro (the “Hotel”) in Kiev, Ukraine.

3. Claimant is represented in this proceeding by Dr. Leopold Specht, Prof. Gianmaria Ajani and Mira Suleimenova of the law firm of Specht Rechtsanwalt GmbH of Vienna, Austria (the “Specht Firm”) and by Laura Steinberg of the law firm of Sullivan & Worcester LLP of Boston, Massachusetts, United States of America. Ukraine is represented in this proceeding by Yuriy D. Prytyka, Deputy Minister of Justice of Ukraine, Larysa Lischynska, Head of Department, Department on Representation of Interests of the State in Courts of Ukraine and in Foreign Judicial Institutions, Ministry of Justice of Ukraine; Nickolay Atanasov, Dmytro Shemelin and Dr. Sergei Voitovich of Grischenko & Partners; and Andriy Alexeyev and Oleg Shevchuk of Proxen & Partners, all of Kiev, Ukraine.

## **II. Procedural History**

### **A. Request for Arbitration**

4. On June 5, 2007, ICSID received a Request for Arbitration dated June 1, 2007 (the “Request”) from Alpha. On June 6, 2007, ICSID confirmed receipt of the Request and transmitted a copy to the Government of Ukraine and the Embassy of Ukraine in Washington, D.C. According to the Request, Alpha submitted the dispute under Article 9 of the UABIT.

### **B. Registration of the Request for Arbitration**

5. On July 25, 2007, the Secretary-General of ICSID notified the parties of the registration of the Request pursuant to Article 36(3) of the ICSID Convention and Rules 6(1)(a) and 7(a) of the Centre’s Rules of Procedure for the Institution of Conciliation and Arbitration Proceedings.

### **C. Appointment of Arbitrators**

6. Claimant informed the Centre on September 24, 2007, that it opted for the method of appointment of arbitrators provided in Article 37(2)(b) of the ICSID Convention, pursuant to which the tribunal (the “Tribunal”) was to “consist of three arbitrators, one arbitrator appointed by each party and the third, who shall be the president of the Tribunal, appointed by agreement of the parties.” Respondent agreed to that approach on September 24, 2007.

7. By letter of October 22, 2007, Claimant appointed Dr. Yoram Turbowicz, a national of the State of Israel, as arbitrator in this proceeding. By letters of Claimant of October 22, 2007, and of Respondent of October 25, 2007, the parties agreed to an extension of the period for constituting the Tribunal until November 22, 2007. By letter of November 22, 2007, Respondent appointed Dr. Stanimir A. Alexandrov, a national of Bulgaria, as arbitrator in this proceeding.

8. By letter of November 23, 2007, Claimant informed the Centre that the parties had not reached an agreement on the candidacy of the President of the Tribunal and requested the ICSID Secretary-General, pursuant to Rule 4(1) of the ICSID Rules of Procedure for Arbitration Proceedings (“ICSID Arbitration Rules”), to refer a request to designate the President of the Tribunal to the Chairman of the Administrative Council of ICSID. On February 4, 2008, the

Chairman appointed Hon. Davis R. Robinson, a citizen of the United States of America, as the third and presiding arbitrator in this proceeding.

9. By letter of February 8, 2008, ICSID informed the parties that the Tribunal was deemed to have been constituted and the proceeding to have begun. Pursuant to Rule 25 of ICSID's Administrative and Financial Regulations, the parties were notified that Ms. Eloïse M. Obadia, Senior Counsel of ICSID, would serve as the Secretary of the Tribunal, and that Ms. Evgeniya Rubinina, Consultant of ICSID, would serve as the Alternate Secretary of the Tribunal. During the course of these proceedings, Ms. Rubinina was succeeded in this latter capacity by Mr. Amine Assouad, Consultant of ICSID, following whose departure Ms. Obadia remained as the sole Secretary of the Tribunal.

#### **D. First Session of the Tribunal**

10. The Tribunal held its First Session with the parties on April 1, 2008, in Washington, D.C. (the "First Session"). The parties agreed that the Tribunal had been properly constituted and confirmed that they had no objections to the appointment of any of its members. In accordance with Article 44 of the ICSID Convention, it was agreed that the ICSID Arbitration Rules in force as of April 10, 2006, would apply to the present proceeding. Pursuant to Article 62 of the ICSID Convention and ICSID Arbitration Rule 13(3), it was agreed that the place of the proceeding would be Paris, France. The minutes of the First Session set forth the parties' agreement as to the schedule and various other procedural matters.

#### **E. Claimant's and Respondent's Requests for Document Production**

##### **1. Procedural Order No. 1 of June 5, 2008**

11. In response to Claimant's May 22, 2008 request for document production, the Tribunal issued Procedural Order No. 1 ("Order No. 1") on June 5, 2008, which ordered that (1) Respondent produce by June 13, 2008, copies of the documents listed in Annex A to Claimant's request; and (2) at mutually agreed times during July 2008, Respondent grant access to the originals of the accounting records and other financial documentation for the commercial arrangements between Alpha and the Hotel at the premises of the Hotel. The Tribunal stipulated



that the production of documents pursuant to Order No. 1 was without prejudice to any other such request that either party in the future might advance during the pendency of these proceedings or to the Tribunal's later assessment of the relevance of the documents ordered for production. The Tribunal further ruled that there would be no extension of the time limits for the parties' written submissions.

## **2. Procedural Order No. 2 of September 8, 2008**

12. On August 27, 2008, Respondent made a separate request for production of documents. On September 8, 2008, the Tribunal issued Procedural Order No. 2 ("Order No. 2"), which ordered that Claimant produce by September 11, 2008, copies of the documents specified in Respondent's request, to the extent that any such documents, including otherwise publicly available documents, were in the possession, power, custody or control of Claimant. Order No. 2 stated that such production of documents was without prejudice to any other such request that either party might make during the pendency of these proceedings or to the Tribunal's later assessment of the relevance of the documents.

### **F. The Parties' Written Submissions Before the Hearing**

13. Pursuant to the parties' agreed schedule, Claimant filed its Memorial on July 1, 2008, and Respondent filed its Counter-Memorial on October 1, 2008. Respondent raised several objections to the Tribunal's jurisdiction and the admissibility of the case, and presented arguments on the merits.

14. Following the submission of the Counter-Memorial, the parties agreed to a second round of pleadings, the schedule for the written submissions, and the date for the oral procedure (the "Hearing"). On November 17, 2008, the Secretary of the Tribunal confirmed the agreed schedule. Pursuant to Claimant's request, the deadlines were subsequently extended to allow Claimant to file its Reply on November 26, 2008, and to allow Respondent to file its Rejoinder on January 21, 2009.

15. Pursuant to the revised schedule, Claimant filed its Reply on November 26, 2008, in which it responded to Respondent's objections to jurisdiction and admissibility. On January 21, 2009, Respondent filed its Rejoinder, in which Respondent reiterated and expanded upon its preliminary objections and presented arguments on the merits. Respondent did not request a separate jurisdictional phase or oppose joining consideration of its jurisdictional objections to the merits of the case.

**G. Procedural Order No. 3 of March 4, 2009**

16. Following the parties' failure to come to an agreement on several procedural issues related to the Hearing, the Tribunal issued Procedural Order No. 3 ("Order No. 3") on March 4, 2009. Order No. 3 resolved several outstanding administrative matters, including the allocation of Hearing time between the parties, the order of expert witness testimony, and witness sequestering. In addition, the Tribunal determined that any new documents that a party wished to introduce during the Hearing would have to be produced no later than the close of business on March 6, 2009; that the other party would then have the opportunity to object to the introduction of any such documents no later than the close of business on March 10, 2009, in which event the Tribunal would promptly rule; that any new documents that a party wished to introduce during the Hearing in response to any new documents produced by the other party as previously determined would have to be produced no later than the close of business on March 13, 2009; and that the other party would then have the opportunity to object to the introduction of any such responsive new documents no later than the close of business on March 17, 2009, in which event the Tribunal would promptly rule.

**H. Claimant's Proffered Production of New Documents**

17. By letter of March 6, 2009, Claimant submitted a significant number of "additional documents" (the "New Documents"). In addition, the March 6 letter concluded by noting that Claimant "now has reason to believe that Respondent has recently engaged in communications with one or more State officials . . . containing information material to the outcome" of the case. Claimant asked that Respondent be "required to produce" such communications (the "Communications").

18. In a letter dated March 10, 2009, Respondent argued against the proposed introduction of the New Documents and objected to Claimant's request for production of the alleged Communications. Claimant replied in its own letter of March 12, 2009. Claimant noted that the Communications purportedly included "a written statement from a former Head of the State Tourism Administration" that is "both relevant and material for the outcome" of this case because "the information provided . . . is unfavorable to Respondent's position." In a responsive letter of the same date, Respondent expressed "substantial difficulty" in understanding the "reasoning" in Claimant's March 12 letter, reiterated its objection to the New Documents, and characterized Claimant's request for the Communications as "an attempt to force Respondent to assist its opponent in collection of documents" in support of its claim. Respondent informed ICSID on March 13, 2009, that it did "not intend to introduce any documents in response to Claimant's documents [*sic*] production."

#### **I. Procedural Order No. 4 of March 14, 2009**

19. In Procedural Order No. 4 of March 14, 2009 ("Order No. 4"), the Tribunal decided, among other things, that it would permit the introduction of the New Documents but only under specified conditions. Depending upon the use to which Claimant would put the New Documents during the Hearing, the Tribunal expressed its intention to grant additional time to Respondent for purposes of examining witnesses and experts, and commenting in its closing statement at the end of the Hearing.

20. The Tribunal also asked Claimant to explain by no later than March 17 how it came to learn of the Communications and their relevance to the proceedings. The Tribunal requested that Claimant identify the former Head of the State Tourism Administration of Ukraine to which Claimant referred and specify the basis for Claimant's supposition that this individual had knowledge and information that were "both relevant and material for the outcome" of the case. The Tribunal stated that, upon receipt and review of this further explanation from Claimant, the Tribunal would grant Respondent the opportunity to respond.

**J. Letter from Mr. Valery Tsybuch**

21. In a letter of March 17, 2009, to the Tribunal, Claimant attached a communication dated March 16, 2009, addressed to Dr. Specht of the Specht Firm, purportedly from Mr. Valery Tsybuch, the former “Head of the State Committee for Tourism of Ukraine” (the “Tsybuch Letter”), in which Mr. Tsybuch, the incumbent Ambassador of Ukraine to Greece, outlined the “history” of the “cooperation” between the Hotel and Alpha.

22. The March 17 letter explained how Claimant came to learn of Respondent’s alleged request to Mr. Tsybuch that he “provide information in connection with the joint activity.” The March 17 letter noted that the “Claimant contacted Mr. Tsybuch [sic] via telephone at the beginning of March 2009” and that, while he would not “confirm the exchange of information” with Respondent “[d]ue to confidentiality concerns,” Mr. Tsybuch nonetheless agreed to provide “written information confirming his position as to the joint activity.”

23. The Tsybuch Letter in the original Russian appears on the letterhead of the “Ambassador of Ukraine in the Hellenic Republic.” It describes how, “since 1994,” the Hotel “started to cooperate successfully” with Alpha which, according to Mr. Tsybuch, was “the only foreign investor who took an active part in development of hotel business in Ukraine at the time, when hotel business was in an extremely deplorable state because of the historical, political and economic situation in the Ukraine after the disintegration of the Soviet Union.” Mr. Tsybuch further reported that the “Austrian party contributed into the joint activity monetary means (including reinvestment) in the amount of approximately 4 million USD.” The letter described the renovations undertaken and concluded that, “due to the financial assistance of the Austrian investor, the financial and economical performance of the Hotel was enhanced and the quality of service was improved.” Mr. Tsybuch referred to the “frequent visits of Mr. Kuess” and noted how he became “convinced” by the “seriousness” of Mr. Kuess’ “intentions.” Mr. Tsybuch wrote that the joint activity “was always properly approved by the competent authorities and all the necessary permissions were always duly issued” and that the “foreign investments contributed by the Austrian investor into Ukraine were duly registered in accordance with the current Ukrainian laws, [and] all the tax- [sic] and budget liabilities were duly fulfilled.” He further expressed the view that the Hotel was “of a vital importance for the state of Ukraine and

for its capital Kiev.” Mr. Tsybuch asserted that it was Alpha’s “[f]inancial support” that “enabled the reconstruction works in the premises of the Hotel” to be carried out in time for Ukraine’s “hosting the summit of the European Bank of Development and Reconstruction [sic].” Finally, Mr. Tsybuch states that at the time that he still “headed” the State Tourist Administration, both the Hotel and the State Tourist Administration “were reckoning on further continuation of the joint activity” with Alpha.

24. In a letter dated March 18, 2009, Respondent objected to Claimant’s “sweeping request for additional . . . production of documents” and argued that the “explanations” of Mr. Tsybuch “represent nothing more than a personal view of a State official, do not disclose any new facts and are in no way ‘material to the outcome of this arbitration proceeding’ . . . .” As such, Respondent submitted that “there may be no justification to introduce the explanations of Mr. Tsybuch at this late stage of the proceedings.” The March 18 letter further alleged that “counsel for Claimant have breached a generally recognised ‘no contact rule’ of professional ethics,” noting that “Mr. Tsybuch . . . is a governmental official of the State of Ukraine, which is Respondent in the present case.”

25. Claimant responded in a letter to the Tribunal dated March 19, 2009, noting that Mr. Tsybuch was “not a party to these proceedings;” that “fact finding by Claimant . . . implies conversations with civil servants of the Ukraine, and with parties who . . . have worked for and at the instructions of Respondent;” that “Respondent has not introduced a written statement of Mr. Tsybuch;” that Counsel for Claimant had “not acted against any rule of professional conduct;” and that Mr. Tsybuch’s letter “should be admitted as evidence in this case.”

#### **K. Letter from the Tribunal to the Parties of March 21, 2009**

26. In a letter to the parties of March 21, 2009, the Secretary of the Tribunal reported that the Tribunal had “carefully considered the correspondence resulting” from Order No. 4. The Tribunal decided that, at the opening of the Hearing, the Tribunal would “allocate from the Tribunal’s time” 15 minutes each to Claimant and Respondent “for the purpose of hearing their respective views” about the Communications and the Tsybuch Letter. The Tribunal called upon

the parties upon that occasion to “provide proposals as to how the Tribunal can best address the issues presented thereby.”

#### **L. The Hearing**

27. The Hearing was held from March 23-27, 2009, at the ICC Hearing Centre in Paris. It began with brief introductory remarks by the President and opening statements of the parties.

28. After having provided Respondent with an opportunity to study Mr. Tsybuch’s letter, and after hearing presentations by each of the parties as contemplated by the March 21 letter, the Tribunal decided that it would reserve judgment as to allowing the introduction of the Tsybuch Letter into evidence.

29. On March 24, 2009, the President announced on behalf of the Tribunal its decision to admit Mr. Tsybuch’s letter, to permit examination of witnesses as to its background and content, and, at a later time, to determine its evidentiary value and probative nature.<sup>1</sup> The President emphasized that the Tribunal wanted to hear from Respondent as to its “needs in order to respond”<sup>2</sup> and to provide Respondent with every fair and reasonable opportunity to decide how it wished to proceed in this regard. On the final day of the Hearing, Counsel for Respondent announced that Respondent “will not request from the Tribunal any procedural steps or any special procedural requests on this matter.”<sup>3</sup>

30. Over the course of the Hearing, the Tribunal heard direct examination, cross-examination, re-direct examination and re-cross examination of the three witnesses introduced by Claimant – Mr. Jakob Kuess (managing director of Alpha), Ms. Ludmila Luganova (a former Director of the Hotel) and Ms. Ludmila Trusova (former head of GEYA, an appraisal firm in Kiev) – and of one witness introduced by Respondent, Mr. Volodmyr Melnikov (a former Director of the Hotel). These witnesses were followed by the examination and cross-examination of Claimant’s legal expert, Mr. Andrii Omelchenko, and then of Respondent’s legal

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<sup>1</sup> Hearing on the Merits, Transcript Day 2, p. 5, lines 8-9 (“Tr. 2”).

<sup>2</sup> *Id.* at lines 12-15.

<sup>3</sup> Hearing on the Merits, Transcript Day 5, p. 179, lines 8-10 (“Tr. 5”).

expert, Mr. Roman Maydanyk, whose testimony, at the urging and with the agreement of the parties, was somewhat abbreviated due to time limitations.

31. The parties decided to forego any closing statements and agreed upon two rounds of written, simultaneous post-hearing submissions, in the first of which each party would provide its “closing argumentation” and respond to questions and requests from the Tribunal.

## **M. Post-Hearing Submissions**

### **1. Correspondence Regarding the Post-Hearing Submissions**

32. In a letter dated April 2, 2009, the Secretary of the Tribunal informed the parties that the first round of simultaneous filings was due on May 18, 2009, and the second round on June 17, 2009. The letter provided additional recommendations with respect to the submissions and requested comments from the parties by no later than April 7, 2009. In a letter dated April 7, 2009, Respondent suggested certain modifications, which the Tribunal accepted subject to the “receipt of any objection” from Claimant no later than April 10, 2009. The Tribunal received no subsequent objection from Claimant.

### **2. The First Round of Post-Hearing Submissions**

33. On May 18, 2009, both parties filed their first round of post-hearing pleadings. On May 20, 2009, Claimant submitted a letter objecting to the page length of Respondent’s submission and calling for “an electronic resubmission” of that pleading in a proper page length by a given date. In a letter dated May 21, 2009, Respondent argued that it was “in strict compliance with the instructions of the Tribunal.”

34. In a letter dated May 22, 2009, the Secretary reported the Tribunal’s decision with respect to Claimant’s May 20 letter and Respondent’s May 21 letter. The Tribunal did not consider Claimant’s objections well-founded and took “no action in response to” them.

### 3. The Second Round of Post-Hearing Submissions

35. The parties submitted their second post-hearing pleadings on June 17, 2009. Respondent wrote to the Tribunal on June 24, 2009, commenting upon accusations by Claimant in its second post-hearing submission that Respondent had “violated some procedural rules” in its first round submission by, for example, introducing new materials such as a letter from Ms. Liliya Timoschik, a Ukrainian Government official. Respondent explained its rationale for producing these new materials. It also argued that an affidavit from Ms. Mira Suleimenova attached to Claimant’s second round submission was “inadmissible” as “completely beyond the sphere” of permitted post-hearing submissions and asked the Tribunal to “disregard” this affidavit and its attachments.

36. In a letter dated June 26, 2009, Claimant responded to the June 24 letter, calling it “an unfair effort to introduce new and unsolicited evidence” and arguing that certain specified documents “cannot be submitted at this stage.” Claimant objected in particular to the letter from Ms. Timoschik, noting that Respondent “chose to forego the opportunity” to respond to Mr. Tsybuch’s letter during the Hearing and did not “mention any desire, let alone any perceived need, to respond to Mrs. Trusova’ [*sic*] testimony” at that time when Claimant would have had a chance to reply. Claimant asserted that the submission from Ms. Timoschik was “an afterthought” that is “at variance with fundamental due process notions.” At the same time, Claimant argued that the affidavit from Ms. Suleimenova that Claimant attached to its first round of post-hearing submissions “does not create new evidence” but rather “simply draws the Tribunal’s attention to the fact that the financial statements submitted by Respondent [with its first round] are incomplete,” with Ms. Suleimenova providing “what was missing” by means of “existing documentation.” The June 26 letter concluded by asking the Tribunal to “disregard” Respondent’s June 24 letter and to “strike from the record or disregard” specified documents.

37. In a letter of June 29, 2009, the Secretary of the Tribunal informed the parties that “the Tribunal will for the time being permit the introduction into evidence” of the various documents and would, during the course of the preparation of its Award, “decide what, if any, heed to pay to any of these materials submitted respectively by Claimant and by Respondent.” The Tribunal has decided to admit the materials as evidence. Allowing admission of the documents does not



prejudice the position of either party and does not materially affect the Tribunal's determination on the merits.

#### **N. Challenge to Dr. Turbowicz Serving as Arbitrator**

38. By a letter to the Secretary of the Tribunal dated January 25, 2010, Respondent proposed the disqualification of Dr. Yoram Turbowicz as a member of the Tribunal ("Respondent's Proposal"). Respondent's Proposal was based upon (a) Article 14(1) of the ICSID Convention providing that a member of an ICSID tribunal "shall" be a person "who may be relied upon to exercise independent judgment;" (b) Article 57 authorizing a party to propose the "disqualification" of any member of a tribunal "on account of any fact indicating a manifest lack of the qualities required by Article 14(1);" and (c) ICSID Arbitration Rule 6(2) requiring that a member of an ICSID tribunal, as part of the appointment process, declare any "past and present . . . relationships . . . with the parties and . . . any other circumstance that might cause . . . reliability for independent judgment to be questioned by a party."

39. As a result of considerable correspondence with the Secretary both before and after the date of Respondent's Proposal, it was established that Respondent's Proposal was directed at: (a) the shared matriculation of Dr. Turbowicz and Dr. Specht of the Specht Law Firm, Counsel to Claimant, in graduate programs at the Harvard Law School in the late 1980's; (b) the failure of the declaration of Dr. Turbowicz of November 10, 2007 under Rule 6(2) (the "Turbowicz Declaration") to include a statement disclosing this educational affiliation and the accompanying acquaintance with Dr. Specht; and (c) a "brief phone call" from Dr. Specht to Dr. Turbowicz in 2007 inquiring as to whether Dr. Turbowicz was available to serve as an arbitrator in this proceeding.

40. In accordance with Article 58 of the ICSID Convention, the two other members of the Tribunal deliberated and dismissed Respondent's Proposal in a decision dated March 19, 2010 (the "Decision"). The Decision held: (a) that on the basis of the plain language and supporting background of Rule 6(2), the part of the required declaration pertaining to "relationships" applied only to relationships of an arbitrator "with the parties;" (b) that on the basis of governing

interpretive standards and of guidance by analogy from the 2004 International Bar Association Guidelines on Conflicts of Interest in International Arbitration, the acquaintanceship of Dr. Turbowicz and Dr. Specht two decades ago at Harvard Law School, without more, did not constitute an “other circumstance that might cause” Dr. Turbowicz’ “reliability for independent judgment to be questioned by a party;” (c) that the “brief phone call” was in keeping with common practice; and (d) that neither the Harvard Law School acquaintanceship nor the “brief phone call,” without more, necessitated disclosure by Dr. Turbowicz.

41. On the basis of the foregoing, the challenge to Dr. Turbowicz was rejected.

### **O. Closure of Proceedings**

42. Pursuant to Arbitration Rule 38(1), the proceeding was declared closed on October 13, 2010.

### **III. Summary of Facts**

43. The events giving rise to this arbitration center on a series of commercial arrangements involving Claimant, the Hotel Dnipro, and other parties regarding the reconstruction and renovation of several floors of the Hotel. The Tribunal shall summarize the facts in the following order: (1) the formation of Alpha; (2) the reconstruction and renovation of floors 11-12 of the Hotel;<sup>4</sup> (3) the reconstruction and renovation of floors 8-10 of the Hotel; (4) the reconstruction and renovation of floors 4-7 of the Hotel; (5) the temporary suspension of payments under the agreements regarding the reconstruction and renovation of floors 11-12; (6) the transformation of the Hotel from a State-owned Enterprise into a State-owned Open Joint Stock Company (OJSC); (7) the agreement between the Hotel and Claimant to reinvest a portion of Alpha’s suspended payments; (8) the transfer of management of the Hotel to the State Administration of Affairs and the Dnipro Elite incident; and (9) the cessation of payments to

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<sup>4</sup> While certain documents refer to work on the 12<sup>th</sup> floor, the 12<sup>th</sup> floor “housed mechanical equipment.” Claimant’s Memorial, p. 2, para. 5, n.1 (“Memorial”). The references to the 12<sup>th</sup> floor in the documents are understood to be references to the 13<sup>th</sup> floor. The parties’ pleadings sometime referred to the 12<sup>th</sup> floor and sometimes to the 13<sup>th</sup> floor. For the sake of consistency, the Tribunal will refer to the 12<sup>th</sup> floor, except when directly quoting from a document in the record.

Claimant, domestic legal proceedings, and related events. At the end of this section, the Tribunal shall make findings with respect to certain disputed facts.

#### **A. Formation of Alpha**

44. Prior to the dissolution of the USSR, State Enterprise (“SE”) Dnipro had been a “protocol” hotel where official government delegations stayed. By 1991, however, Ukraine was in a deep economic crisis and the SE Dnipro had fallen into disrepair.<sup>5</sup>

45. Claimant first became involved in upgrading the Hotel in 1991, when Mr. Kuess reached an agreement with the Director of the Hotel, Mr. Alexander Nichiporenko, to facilitate the purchase of furniture for 40 of the Hotel’s deluxe rooms. In spite of the many uncertainties at the time, Mr. Kuess viewed the hotel business in Ukraine as “an untapped market with great future potential.”<sup>6</sup>

46. After further discussions, Messrs. Kuess and Nichiporenko decided to enter into an agreement for the reconstruction of the top floors of the Hotel. Alpha was founded in 1993 to assist in the effort. Alpha was initially owned by the following three parties: Konitch Limited (“Konitch”), which held a 50% share of Alpha; Alpha Baumanagement GmbH, an Austrian limited liability company, which owned 10%; and Ecco Versicherungsmakler GmbH, an Austrian limited liability company controlled by Mr. Kuess, which held the remaining 40%. The role Konitch played in Alpha was the subject of discussion during the proceeding.

47. Respondent presented evidence that Konitch was owned by Mr. Nichiporenko and Mr. Piotr Kovalenko, each of whom held a 50% interest and each of whom provided the same Kiev, Ukraine address.<sup>7</sup> The name “Konitch” was apparently a combination of “Ko” from Kovalenko and “nitch” from Nichiporenko. As noted, Mr. Nichiporenko was the Director of the Hotel. Furthermore, according to Respondent, Mr. Kovalenko is a Ukrainian national and the father of

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<sup>5</sup> Affidavit of Jakob Kuess, para. 3 (“Kuess Affidavit”); Affidavit of Ludmila Luganova, para. 6 (“Luganova Affidavit”).

<sup>6</sup> Kuess Affidavit, para. 4.

<sup>7</sup> Doc. R-49.

Mr. Pavel Kovalenko, who was the head of Pakova Investment Ltd. (“Pakova”), a Cyprus construction company that, as explained below, was the contractor that undertook the construction work involved in the renovation of the Hotel.<sup>8</sup> According to Respondent, Mr. Pavel Kovalenko and Mr. Nichiporenko’s son were directors of Konitch.<sup>9</sup>

48. Mr. Kuess testified that he had initially “forgotten” that Konitch was a founding member of Alpha.<sup>10</sup> Claimant did not refer to Konitch in its Memorial, but, following Respondent’s objection, acknowledged that Konitch “owned half of Alpha’s equity” at the time of its founding.<sup>11</sup>

49. Mr. Kuess also claimed ignorance of Mr. Nichiporenko’s involvement in Konitch. Mr. Kuess admitted to having had a “good personal relationship” with Mr. Nichiporenko,<sup>12</sup> but claimed to have become aware of Mr. Nichiporenko’s involvement only after it was revealed by Respondent.<sup>13</sup> He further testified that, on the basis of the documentation that Mr. Pavel Kovalenko presented upon the formation of Alpha, Mr. Kuess could not have known that Mr. Nichiporenko was a “stakeholder in Konitch” and that he and Mr. Kovalenko “never discussed the matter.”<sup>14</sup> According to Mr. Kuess, Pavel Kovalenko never presented him with a certificate of Konitch shareholders and he never asked for one.<sup>15</sup> Mr. Kuess stated that he had been under the impression that Pavel Kovalenko was the founder and owner of Konitch,<sup>16</sup> though he also claimed that, by the time of the arbitration, he had forgotten that “Pavel Kovalenko was one of

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<sup>8</sup> Respondent’s Rejoinder, Supplement 1, para. 6 (“Rejoinder”).

<sup>9</sup> Doc. R-52.

<sup>10</sup> Supplemental Affidavit of Jakob Kuess, para. 4 (“Kuess Supplemental Affidavit”).

<sup>11</sup> Claimant’s Reply, p. 1, para. 1 (“Reply”).

<sup>12</sup> Rejoinder, Supplement 1, paras. 1-2.

<sup>13</sup> Reply, p. 2, para. 2 (claiming that “Claimant” did not know of Mr. Nichiporenko’s involvement in Konitch and noting that Mr. Nichiporenko was not a signatory for Konitch); Testimony of Jakob Kuess (“Kuess Testimony”), Hearing on the Merits, Transcript Day 3, p. 45, lines 18-24 (“Tr. 3”) (testifying that he did not know of Mr. Nichiporenko’s involvement in Konitch until preparations for this arbitration).

<sup>14</sup> Hearing on the Merits, Transcript Day 1, p. 209, lines 13-17 (“Tr. 1”).

<sup>15</sup> Tr. 1, p. 203, lines 15-16; Tr. 3, p. 32, lines 6-17.

<sup>16</sup> Kuess Supplemental Affidavit, para. 4.

the founders” of Alpha.<sup>17</sup> Respondent expressed skepticism of Claimant’s alleged ignorance on these matters.<sup>18</sup>

50. According to Mr. Kuess, it was Pavel Kovalenko’s personal involvement that was important, not any action by Konitch.<sup>19</sup> Mr. Kuess testified that, while he had no prior dealings with Pakova, he understood that Pakova “was the only foreign construction company then operating on the Ukrainian market and [that it] had already worked on several hotel projects in the Ukraine.”<sup>20</sup> Mr. Kuess testified that it was Pavel Kovalenko who had suggested that Konitch be involved.<sup>21</sup>

51. Under the general terms of the arrangements that would eventually be worked out, Pakova would undertake the reconstruction and renovation of the Hotel. Alpha would take out a bank loan to pay Pakova, and then Alpha would be paid by the Hotel through monthly compensation facilitating the service of Alpha’s bank debt. Pavel Kovalenko served as the personal guarantor of the loan to Alpha, given that, according to Mr. Kuess, “Konitch would never have been respected by the bank.”<sup>22</sup> Furthermore, according to Mr. Kuess, through Konitch, Pavel Kovalenko would participate in Alpha to help ensure that Alpha would pay Pakova and that Pakova in turn would complete its work on time and on budget.<sup>23</sup> Pavel Kovalenko’s involvement can be summarized as follows: (1) in his personal capacity, he was the guarantor of the loan to Alpha; (2) as a director of Konitch, which owned half of Alpha, he would help ensure payment to Pakova with the loan proceeds; and (3) he was the head of Pakova, which received the payments made with the loan proceeds to undertake the renovation and reconstruction of the Hotel.

52. Mr. Kuess emphasized that it was understood from the beginning that Konitch would cease being an Alpha shareholder as soon as Pakova had completed its work and its construction

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<sup>17</sup> Kuess Testimony, Tr. 1, p. 194, lines 18-25.

<sup>18</sup> Rejoinder at Supplement 1, paras. 1-2; *see also* Doc. C-202 (listing Konitch among the shareholders in Alpha).

<sup>19</sup> Tr. 1, p. 197, lines 1-25; p. 198, lines 1-14; Tr. 3, p. 48, lines 17-20.

<sup>20</sup> Kuess Affidavit, para. 7.

<sup>21</sup> Tr. 1, p. 194, lines 18-25; p. 195, lines 3, 16-17.

<sup>22</sup> Kuess Testimony, Tr. 3, p. 35, lines 21-25; p. 36, line 1.

<sup>23</sup> Kuess Testimony, Tr. 3, p. 46, lines 8-9; p. 47, lines 1-25; p. 48, lines 1-3.

warranties had expired.<sup>24</sup> Konitch was apparently “dissolved” on November 19, 1999.<sup>25</sup> However, it was not until June 25, 2002, that Konitch’s interest in Alpha was assigned to Alpha Baumanagement for the nominal “assignment price” of one schilling.<sup>26</sup> The Assignment Agreement was based upon a Power of Attorney dated July 2, 1999, from Pavel Kovalenko.<sup>27</sup>

53. Claimant argues that Konitch “never controlled Alpha” and was no longer a shareholder in Alpha after 1999.<sup>28</sup> Mr. Kuess stated that Pavel Kovalenko, as the general director and designated signatory for Konitch, “delegated his powers to a collaborator” of Alpha immediately upon the formation of Alpha.<sup>29</sup> Mr. Kuess did not point to any documentation to support this statement. As the Tribunal understands Mr. Kuess’ testimony, this delegation of powers effectively included a proxy for Konitch’s shareholding in Alpha,<sup>30</sup> a point that Respondent did not challenge. Thus, according to Mr. Kuess, Konitch had no operational rights in Alpha, let alone control.<sup>31</sup> Mr. Kuess stated that he believed that Pavel Kovalenko “was the person who signed on Konitch’s behalf. In fact, he was the only person who was identified as authorized to sign for Konitch.”<sup>32</sup>

54. The Tribunal has doubts as to whether Mr. Kuess was truly unaware of the ownership of Konitch. Given the prominent ownership stake and role Konitch played in Alpha, and Mr. Nichiporenko’s involvement in Konitch, it would be surprising in the existing business environment, the Tribunal believes, if the ownership did not come to light. The Tribunal is also not quite convinced by Mr. Kuess’s explanation of the need for, and purpose of, the convoluted ownership and financing arrangements leading to the creation of Alpha, and is concerned about Mr. Nichiporenko’s apparent conflict of interest given his position as Director of the Hotel. The

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<sup>24</sup> Tr. 3, p. 36, lines 5-12; Tr. 1, p. 196, lines 2-23.

<sup>25</sup> Doc. R-49.

<sup>26</sup> Doc. C-200.

<sup>27</sup> *Id.*

<sup>28</sup> Reply, p. 2, para. 1, (citing Supplemental Kuess Affidavit at para. 4). In the referenced section of Mr. Kuess’ Supplemental Affidavit, he in fact states only that “Konitch at some point ceased to be a shareholder of Alpha” and that “the decision to assign Konitch’s interest in Alpha to Alpha Baumanagement was made in July 1999.” As noted, the assignment did not actually take place until 2002.

<sup>29</sup> Tr. 1, p. 196, lines 2-8; p. 197, lines 1-3.

<sup>30</sup> Tr. 1, p. 197, lines 17-25; p. 198, lines 1-14; p. 200, lines 10-25.

<sup>31</sup> Tr. 1, p. 200, lines 10-25.

<sup>32</sup> Kuess Supplemental Affidavit, para. 4; Doc. C-199, pp. 11-12.

Tribunal is further concerned that Mr. Kuess may have known about this conflict of interest, yet proceeded with the project.

55. Despite the questions surrounding the formation of Alpha, however, Respondent does not explicitly allege any illegality in this regard, and the Tribunal is thus not called upon to make a ruling on the matter. Respondent does, however, challenge the admissibility of Claimant's claims given Konitch's 50% shareholding in Alpha and the fact that the owners of Konitch, Mr. Nichiporenko and Mr. Piotr Kovalenko, were both Ukrainian nationals.<sup>33</sup> The Tribunal shall address this matter in section VI.E below.

### **B. Alleged Agreements Regarding Construction and Renovation of Floors 11 and 12**

56. The first reconstruction effort involved only floors 11 and 12 of the Hotel. The facts in dispute referenced below are addressed at the end of this section or where otherwise indicated.

57. According to Claimant, the arrangements regarding the reconstruction were negotiated through an "integrated package of documents,"<sup>34</sup> the first of which was negotiated in 1994. Due to changes in the FIL and various legal infirmities with the original agreements, new agreements were negotiated in 1996 and again in 1998. Claimant stated that "[t]he 1998 JAA [joint activity agreement] terminated all of the previously executed agreements," citing Article 10.3 of that agreement, which is explicit on this point.<sup>35</sup> Respondent does not contest that conclusion. While the parties have discussed the pre-1998 agreements in great detail, neither party has clearly explained the continuing relevance of those agreements to this dispute, given that Claimant's claims relate only to the 1998 and subsequent agreements and that the events giving rise to this dispute took place long after the pre-1998 agreements were terminated. This matter is addressed further in sections IV.A and VI.D.3.d below.

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<sup>33</sup> Tr. 1, p. 53, lines 3-22.

<sup>34</sup> Memorial, p. 4, para. 9.

<sup>35</sup> Memorial, p. 7, para. 20. Article 10.3 of the 1998 JAA states that "[c]onclusion of this Agreement shall terminate all previous legal documents listed in Annex 1 hereto which comprises an integral part thereof." Annex 1 lists the previous agreements between July 3, 1994, and November 14, 1996.

## 1. Positions of the Parties

### a. The First General Agreement

58. According to Claimant, on February 21, 1994, Mr. Nichiporenko sent a letter to the “Ukrainian Committee for Tourism” requesting permission to undertake reconstruction of floors 11 and 12 of the Hotel and to engage in a “cooperative exploitation” with Alpha. Permission was granted in a handwritten note on the same letter the next day, which stated that the request was “[a]pproved in accordance with the Joint Activity Agreement for ten years.”<sup>36</sup>

59. According to Claimant, the Hotel, Alpha and Pakova executed two agreements on July 3, 1994. These consisted of the “First General Agreement” and the 1994 Joint Activity Agreement (“1994 JAA”), which will be discussed below.

60. The “First General Agreement” is dated July 3, 1994, but does not record any place of signature, at least in the translation. Respondent asserts that the untranslated version of the document indicates the place of signature as Kiev.<sup>37</sup> Key elements of the First General Agreement included the following:

- *The Parties:* The agreement describes the Hotel as the “Customer,” Alpha as the “Investor” and Pakova as the “Contractor.” The parties were represented by Messrs. Nichiporenko, Kuess, and Kovalenko respectively.
- *Objectives/Purpose:* The agreement sets out general goals for the project and contemplates a contemporaneous “Joint Activities Agreement” as “part of the package of documents” related to the renovation of the top floors.
- *Alpha’s Obligations:* Alpha would “invest” USD 1,435,000 in the reconstruction activities and equipment. Of this amount, USD 885,000 would be dedicated to the 12<sup>th</sup> floor, and USD 550,000 would be dedicated to the 11th floor.<sup>38</sup>
- *Statements Regarding the Parties’ Joint Activity:* Several provisions of the agreement refer to the parties’ “joint activities” or “joint operation.” The agreement states, for example, that “[t]he Customers [*sic*] and the Investor shall

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<sup>36</sup> See Memorial, p. 2, para. 4; Doc. C-103.

<sup>37</sup> Respondent’s Counter-Memorial, para. 18, n.17 (“Counter-Memorial”).

<sup>38</sup> Doc. C-104, Art. 2.



act jointly during the reconstruction and following operation of the reconstructed part of the Hotel.”<sup>39</sup>

- *Payments by Alpha:* According to the agreement, Alpha was to “mak[e] bank transfers of the relevant amounts to the Contractor, which shall use these funds to purchase construction materials and equipment, deliver those to the Dnipro Hotel for its own account and carry out the works at the hotel in the volumes specified therein.”<sup>40</sup>

61. There are three areas of dispute regarding the First General Agreement. First, the parties disagree as to whether the agreement and related investments were properly registered and thus as to the legal effects of such registration. Second, Respondent claims that the First General Agreement was backdated from sometime in October-November 1996. Third, Respondent claims that, in any case, the First General Agreement does not establish the existence of an investment in Ukraine, as Alpha made payments directly to Pakova outside Ukraine and not to the joint activity.<sup>41</sup>

#### **b. 1994 JAA**

62. According to Claimant, the Hotel and Alpha executed a second agreement on July 3, 1994, entitled “Contract of joint activity on building, joint reconstruction and operation of the 13th and 11th floors of the Dnipro Hotel” (the “1994 JAA”).<sup>42</sup> The words “Villach, 3 July 1994” appear after the signature lines, though Appendix 1 to the 1994 JAA has the word “Kiev” after its signature line. Key elements of the 1994 JAA included the following:

- *The Parties:* The agreement was between the Hotel, represented by Mr. Nichiporenko, and Alpha (described as “the Company”), represented by Mr. Kuess.
- *Objectives/Purpose:* The subject of the agreement was defined as the construction/re-construction of the 11th and 12th floors, “followed by their joint operation by the Parties.”
- *Alpha’s Obligations:* Alpha was to complete the works related to the 12th floor by January 1, 1995, and the works related to the 11th floor by March 30, 1995.

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<sup>39</sup> *Id.* at Art. 6.1.

<sup>40</sup> Doc. C-104, Art. 3.1.

<sup>41</sup> Counter-Memorial, para. 15.

<sup>42</sup> Doc. C-105.

Appendix 1 states that “the cost of the construction and equipment” for the 11th and 12th floors would be USD 590,000 and USD 980,000, respectively, for a total of USD 1,570,000.

- *Hotel’s Obligations:* Among other things, the Hotel was required to put the 11th and 12th floors at Alpha’s disposal for “joint operation” by the parties.
- *Statements Regarding the Parties’ Joint Activity:* Several provisions refer to the “joint operation” of the floors and related “joint activity.”
- *Division of Profits:* After “turnkey delivery” of the “objects” on the 11th and 12th floors, the parties were to jointly operate the two floors for ten years, with a possible extension for another ten years. The “profits gained from such joint operation” were to be “shared by the Parties in the ratio” of 70% for Alpha and 30% for the Hotel for the first ten years, and 50%-50% for any extension thereafter.<sup>43</sup>

63. Respondent alleges that this document was backdated. The Tribunal notes, however, Mr. Kuess’ testimony that the original bank loan documents are dated July 5, 1994 and that the Austrian bank would not have issued the loan without supporting underlying agreements among the Hotel, Alpha and Pakova whose head, Mr. Pavel Kovalenko, personally guaranteed the bank loan.<sup>44</sup> In addition, Respondent notes that a legal opinion prepared by a Ukrainian attorney, Mr. A. I. Rozenblit, on September 9, 1996, on behalf of the Hotel<sup>45</sup> concluded that the 1994 JAA was “*de jure* void as a joint activity agreement, since it did not contain necessary provisions contemplated by the law.”<sup>46</sup>

### **c. Second General Agreement**

64. Claimant alleges that, on July 24, 1994, Alpha and the Hotel entered into a Second General Agreement (“General Agreement of Investments Into the Construcion [*sic*] Works”).<sup>47</sup> The agreement identifies Alpha as the “Investor,” and indicates that it would be responsible for financing the construction and/or renovation of the 11th and 12th floors to 4-star standards. According to the agreement, “[t]he fixed prices which shall be paid by the Investor” would be USD 885,000 for the 12th floor and USD 550,000 for the 11th floor, for a total of

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<sup>43</sup> Doc. C-105; *see also* Memorial, p. 3, para. 6.

<sup>44</sup> Tr. 1, p. 197, lines 1-16; p. 227, lines 1-22.

<sup>45</sup> Doc. R-15 (concluding that the agreement conflicted with the laws governing joint activities and “are, in accordance with Art. 48 of the CC, invalid from the moment of conclusion thereof”).

<sup>46</sup> Counter-Memorial, para. 19.

<sup>47</sup> Doc. C-106.

USD 1,435,000. The 12th floor was to be handed over to the Hotel by May 15, 1995, and the 11th floor was to be handed over at a time to be agreed in a separate “additional agreement.”

65. Respondent asserts that this agreement, too, was backdated. Respondent also notes that the agreement does not specify whether payments will be made to the Hotel or to any joint activity.<sup>48</sup>

**d. Additional Agreement on Profit Distribution**

66. Claimant maintains that, on July 24, 1994, the Hotel and Alpha executed an Additional Agreement on profit distribution.<sup>49</sup> The agreement specified the “[t]erm of building and reconstruction works for the 13<sup>th</sup> floor” as August 1, 1994 - December 31, 1994, which was apparently then amended to September 1, 1994 - February 15, 1995. The agreement specified the “[t]erm of performance of reconstruction works on the 11th floor” as January 1, 1995 - March 31, 1995. This agreement reiterated the 30/70 allocation of income from the 11th and 12th floors but stated that “[t]he 70% share of [Alpha] includes all costs related to credit repayment and profit share . . . . Upon credit repayment the profit shall be distributed in 50/50 ratio.”<sup>50</sup> The last page of the English translation of this Additional Agreement states “(signature) Kiev 24 July 1994.”

67. Respondent asserts that “[t]he date and place in the translation [of the Additional Agreement] . . . is a pure invention.”<sup>51</sup> Respondent also asserts that the Additional Agreement demonstrates that “the relations between Alpha and the Hotel are those of a lender and a borrower rather than of an investor and an investee.”<sup>52</sup> This matter will be discussed in the section on jurisdiction below.

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<sup>48</sup> Counter-Memorial, paras. 21-23.

<sup>49</sup> Doc. C-107; *see also* Memorial, p. 3, para. 7.

<sup>50</sup> Doc. C-107.

<sup>51</sup> Counter-Memorial, para. 24.

<sup>52</sup> *Id.* at para 25.

**e. Construction Contracts**

68. On August 15, 1994, the Hotel and Pakova purportedly entered into a contract for the reconstruction of the 12th floor.<sup>53</sup> On May 16, 1995, the Hotel and Pakova entered into another construction contract for the renovation work on the 11th floor.<sup>54</sup> Respondent raises questions as to the authenticity of the documents and asserts that the agreements between the Hotel and Pakova were bilateral contracts that did not relate to any alleged joint activity.<sup>55</sup>

**f. Third General Agreement**

69. On September 15, 1994, the Hotel and Alpha allegedly entered into a “Third General Agreement.”<sup>56</sup> This agreement is dated “15 September 1994 Kiev.” Key terms of the Third General Agreement included the following:

- *The Parties:* The agreement refers to Hotel Dnipro as the “Contractor” and Alpha as the “Client.” The parties were again represented by Messrs. Nichiporenko and Kuess respectively.
- *Alpha’s Obligations:* The agreement states that the “Intentions of the Client” are “to finance construction work of the 13th floor, to renovate the 11th floor of the Hotel and to equip it fully as a ‘turn-key’ Object.” The “fixed price” to be paid by Alpha was USD 885,000 for the works related to the 13th floor and USD 550,000 for works related to the 11th floor, for a total of USD 1,435,000. The work on the 11th floor was to be completed by March 31, 1995, and the work on the 12th floor was to be completed by February 15, 1995.
- *Payments by Alpha:* Alpha was “to pay all the amounts mentioned . . . to [a specified] currency account of the Contractor [*i.e.*, the Hotel] . . . .”
- *References to the Parties’ Joint Activities:* The Third General Agreement does not refer to “joint activities.”
- *Hotel’s Obligations:* The Hotel was responsible for, among other things, the construction work and obtaining the necessary approvals.

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<sup>53</sup> Doc. C-109.

<sup>54</sup> Doc. C-116.

<sup>55</sup> Counter-Memorial, paras. 27-28.

<sup>56</sup> Doc. C-111 (titled “General Agreement” but referenced by the Parties as the “Third General Agreement”).

70. Respondent does not allege that this document was backdated. Instead, it asserts that this “was the original document, and not a refinement of the First General Agreement. . . .”<sup>57</sup> Respondent also notes that this was a “bilateral agreement” that did not include Pakova.<sup>58</sup>

71. Respondent argues that the parties appear not to have complied with the provision in the Third General Agreement requiring Alpha to make payments to the Hotel. Instead, it appears that Alpha paid Pakova directly. Claimant does not deny this fact. Indeed, the Tribunal notes that certain payment authorizations from the Hotel referring to the Third General Agreement (and not the alleged Second General Agreement) appear to authorize direct payments to Pakova. For example, the Hotel authorized Alpha on September 19, 1994, to make a payment to Pakova’s Cyprus bank account of USD 265,500 and on November 1, 1994, a payment to Pakova’s account of USD 400,000.<sup>59</sup> While, in both instances, the authorizations refer to the Third General Agreement, which calls for payment to “Ukreximbank in Kyiv,”<sup>60</sup> it appears that payments were made directly from Alpha to Cyprus.<sup>61</sup>

72. Respondent draws three conclusions from the fact that Alpha may have made payments directly to Pakova. First, it asserts that the Third General Agreement “was a fictitious agreement.”<sup>62</sup> Second, Respondent asserts that such direct payments are evidence that Alpha was merely extending credit to the Hotel and was not engaged in any “joint activity.”<sup>63</sup> Third, Respondent asserts that direct payments to Pakova not only diverged from the terms of the Third General Agreement but were a “violation of the currency control regulations.”<sup>64</sup> Respondent does not, however, explain the alleged violation of the currency control regulations.

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<sup>57</sup> Counter-Memorial, para. 30.

<sup>58</sup> *Id.*

<sup>59</sup> Doc. C-125.

<sup>60</sup> *See* Doc. C-111, Section 8, (providing bank information in a section entitled “Payment Terms”).

<sup>61</sup> Doc. C-125. Respondent asserts that “[t]he allegedly [sic] payment documents in Doc. C-125 may not be admissible since they are not in the procedural language and not accompanied with translations. Doc. C-113 in the part of payments represents uncertified self-serving information.” Counter-Memorial, n.31.

<sup>62</sup> Counter-Memorial, para. 30.

<sup>63</sup> *Id.* at para. 32.

<sup>64</sup> *Id.* at para. 30.

73. On May 14, 1995, the Hotel and Claimant concluded an “Additional Agreement dated 14 May 1995 to the General contract concluded between the Parties on 24.07.1994,”<sup>65</sup> (*i.e.*, the Second General Agreement) which, among other things, reconfirmed the USD 550,000 cost for renovating the 11th floor. Respondent asserts that the parties “invented” the “Additional Agreement” to address the aforementioned problems with the Third General Agreement.<sup>66</sup> While the Additional Agreement refers to the Second General Agreement, not to the Third, Respondent asserts that the Additional Agreement was designed “most likely in order to muddle the business or to cover the tracks.”<sup>67</sup>

74. According to Claimant, as of January 1996, Alpha had “paid 1,435,000.00 USD as an investment into the joint activity” and also supplied equipment and “paid custom duties” for the Hotel.<sup>68</sup>

#### **g. 1996 JAA and Related Documents**

75. On April 25, 1996, Ukraine adopted the FIL.<sup>69</sup> On September 9, 1996, Mr. Rozenblit issued a legal opinion prepared for the Hotel concluding that the arrangements between the Hotel and Alpha, as structured at that time, violated Ukrainian law in certain specified aspects (such as the Hotel’s failure to maintain separate bank accounts for the joint activities) and consequently might not be enforceable.<sup>70</sup>

76. On October 10, 1996, the Hotel and Alpha amended the 1994 JAA by executing “Investment and Joint Activities Agreement No. 4” (the “1996 JAA”).<sup>71</sup> Key elements of the 1996 JAA included the following:

- *The Parties:* The parties to the agreement were the Hotel, represented by Mr. Nichiporenko, and Alpha, represented by Mr. Kuess.

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<sup>65</sup> Doc. C-114.

<sup>66</sup> Counter-Memorial, para. 30.

<sup>67</sup> *Id.* at para. 30.

<sup>68</sup> Memorial, p. 4, para. 11.

<sup>69</sup> Doc. C-13.

<sup>70</sup> Doc. R-15.

<sup>71</sup> Doc. C-118.

- *Objectives/Purpose*: The agreement states that the parties to the 1994 JAA “have agreed to amend and restate that Agreement and enact the version from October 1, 1996.” The agreement covers works related to the 11th and 12th floors of the Hotel. Furthermore, the agreement stated that it “has been made for the purposes of extending and improving the guest services of the Hotel and increase [*sic*] the incomes of the Parties from the joint activities.”
- *The Parties’ Obligations*: Alpha would “invest” USD 1,540,000. The Hotel would provide space on the 11th and 12th floors for the construction and would “take part in the works related to operation of the rooms and bar” on floors 11 and 12. The agreement states that “[t]he Parties consider their contributions to the joint activities as equal.”
- *References to the Parties’ Joint Activities*: The agreement contains numerous references to the parties’ joint activities.
- *Balance Sheets*: Separate balance sheets were to be maintained for the joint activities.
- *Division of Profits*: Profits were to be shared equally beginning in October 1996, but Alpha’s “profit share” would “not be less than 35,000 USD . . . per month.”
- *Duration*: The agreement would remain in effect until November 2001.<sup>72</sup> Upon the termination of the agreement, “the rights of ownership, use and disposals of the rooms and bar which are objects of the joint activities” would be deemed transferred to the Hotel “without any reimbursement” to Alpha.

77. On November 14, 1996, the Hotel, Alpha and Pakova executed a “Certificate of Acceptance of Investments in the Dnipro Hotel”<sup>73</sup> that stated in part that “the Parties agree that the investment in the reconstruction and equipment of the 11-th and 13-th (12-th) floors of the Dnipro Hotel actually totals USD 1,528,180.00.”<sup>74</sup> This figure was also confirmed in the “Additional Agreement to the General Agreement of 3 July 1994” allegedly entered into by the Hotel, Claimant, and Pakova on November 14, 1996.<sup>75</sup>

78. Respondent asserts that the Additional Agreement was “fabricated” at the same time as the First and Second General Agreements *i.e.*, sometime in 1996.<sup>76</sup> With respect to the Certificate of Acceptance, Respondent asserts that (1) the cited amount of the investment, USD

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<sup>72</sup> Doc. C-118, Art. 11.1; *but see id.* at Art. 13.2 (providing for transfer of the “rights of ownership, use and disposals [*sic*] of the rooms” after October 1, 2001).

<sup>73</sup> Doc. C-119.

<sup>74</sup> *Id.*

<sup>75</sup> Doc. C-120.

<sup>76</sup> Counter-Memorial, para. 43.

1,528,180, is an overstatement because the Hotel had repaid Alpha USD 776,238; (2) the original Russian document makes it clear that the payments were not “for” or “intended for” reconstruction (and thus were not part of an “investment”) but were simply payments of money<sup>77</sup>; (3) the money was paid to Pakova, not the Hotel; (4) the works had already been transferred to the Hotel, “so again there was nothing to transfer and accept on November 14, 1996;” and (5) there was nothing in the Certificate evidencing “joint activity.”<sup>78</sup>

79. On November 18, 1996, Mr. Rozenblit issued a second legal opinion, which concluded that the 1996 JAA was “lawful” and complied with current Ukrainian law on joint activities and with the FIL.<sup>79</sup>

#### **h. The 1998 JAA**

80. During the summer of 1998, Mr. Nichiporenko became ill and Ms. Ludmila Luganova became the Hotel’s acting general director.<sup>80</sup> The minutes of a meeting between the Hotel and Alpha on September 17, 1998, indicate that the Hotel had not fulfilled its obligations under the 1996 JAA with respect to certain accounting matters.<sup>81</sup> The minutes also indicate that the Hotel was “instructed” to draft a new version of the JAA and that an appraisal was to be made of the Hotel’s contribution to the joint activity.<sup>82</sup> GEYA Ltd. of Kiev (“GEYA”) was hired to conduct the appraisal. In its report of September 29, 1998, GEYA valued the Hotel’s contribution of the use of the 11th and 12th floors at US \$1,522,934, or approximately equivalent to the aggregate amount expended by Alpha on the renovation of those floors.<sup>83</sup> In early October 1998, Ms. Luganova formally replaced Mr. Nichiporenko as the director of the Hotel.<sup>84</sup>

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<sup>77</sup> Respondent asserts that, properly translated, the relevant provision of the Certificate states that the payments were “connected with construction and reconstruction.” Counter-Memorial, para. 40. The Tribunal fails to see a meaningful difference between the translations presented by Claimant and Respondent.

<sup>78</sup> See Counter-Memorial, paras. 40-42.

<sup>79</sup> Doc. R-16.

<sup>80</sup> Luganova Affidavit, para. 3.

<sup>81</sup> Doc. C-123.

<sup>82</sup> *Id.*

<sup>83</sup> Doc. C-124.

<sup>84</sup> Kuess Affidavit, para. 19.



81. On October 24, 1998, representatives of Alpha and the Hotel executed the new “Agreement on Joint Investment Activities” (“1998 JAA”).<sup>85</sup> Key elements of the 1998 JAA included the following:

- *The Parties*: The agreement was between the Hotel, represented by Ms. Luganova, and Alpha (identified as the “Investor”), represented by Mr. Kuess.
- *Objectives/Purpose*: Among other things, the Hotel and Alpha “agreed to amend the Agreement, dated 3 July 1994.” The agreement expressly stated that “[c]onclusion of this Agreement shall terminate all previous legal documents listed in Annex 1 hereto which comprises an integral part thereof.” Annex 1 lists 13 separate agreements beginning with the “First General Agreement” and ending with the agreements of November 14, 1996.
- *Alpha’s Obligations*: Alpha was to “take part in joint activities through investing money funds into the reconstruction (construction)” efforts related to the 11th and 12th floors.
- *Hotel’s Obligations*: The Hotel was to “make available the facilities on the 11th and 12th floors for reconstruction (construction), furnishing the rooms and the bar; it shall also take part in maintenance. . . .” The Hotel was to “manage the current joint activities” and “take all relevant legal actions . . . in compliance with the current legislation.”
- *References to the Parties’ Joint Activities*: The agreement makes several references to the parties’ joint activities. For example, it states that the parties “undertake to conduct joint activities related to further use” of the 11th and 12th floors “through unifying their property and efforts,” and states that the “purpose of concluding this Agreement is to earn profit from joint activities resulting from providing better service to the Hotel’s visitors.”
- *Payment into the “Joint Activity”*: “All financial and business operations in the framework of joint activities of the Parties” was to be “performed through the settlement account of the Hotel,” and the Director of the Hotel had the right to manage the funds.
- *Value of Contributions*: The contribution of the Hotel was valued at USD 1,522,934, and Alpha’s contribution was valued at USD 1,528,180. The agreement stated that “[t]he contributions of the Parties into the joint activities shall be deemed equal to 50% each.” Annex 2 of the agreement contains the “expert appraisal” of GEYA that valued the “investment contributed” by the Hotel under the “First General Agreement” of July 3, 1994 at USD 1,522,934.

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<sup>85</sup> Doc. C-127.

- *Allocation of Profits*: Profits were to be divided equally. However, Alpha was to receive a minimum of USD 35,000 per month.
- *Duration*: Neither party possessed “the right to unilaterally terminate” the agreement, which was to “remain in full force and effect until 3 July 2004.” “Upon expiration of this Agreement . . . the funds and the property” were to “be divided between the Parties proportionally to their investment after reimbursement of all debts resulting from the joint activities . . . .”

82. Respondent asserts that the 1998 JAA gave only the appearance of a legitimate “joint activity.” Respondent asserts that the USD 35,000 monthly payments bore no relationship to the Hotel’s profits, and that the agreement was nothing more than a disguised loan agreement.<sup>86</sup>

83. On November 3, 1998, the Hotel and Alpha entered into an “Additional Agreement” to the 1998 JAA, creating separate “settlement” and “currency” accounts for the joint activity as required by Ukrainian law.<sup>87</sup> The minutes of a November 15, 1998, meeting between Alpha and the Hotel confirmed the “transfer of profit” for October of 1998 “in a minimal amount of 35,000 US dollars . . . without making additional calculations.”<sup>88</sup>

## C. Agreements to Renovate Floors 8-10 of the Hotel

### 1. 1997 Agreement Between Hotel and Pakova

84. On November 3, 1997, the Hotel and Pakova entered into a contract for the renovation of floors 8-10 of the Hotel.<sup>89</sup> Alpha was not a party to this contract. The contract price was USD 2,776,000; however, Ms. Lukanova testified that the Hotel was able to finance only approximately USD 1,000,000 and could not obtain a loan for the remainder because the Hotel could not pledge state property as collateral.<sup>90</sup> Furthermore, according to Ms. Lukanova, litigation would “have been very embarrassing, at a time when the government was trying to demonstrate that the economy had stabilized and to lure foreign investors to return to Ukraine.”<sup>91</sup>

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<sup>86</sup> Counter-Memorial, paras. 51-53.

<sup>87</sup> Doc. C-128.

<sup>88</sup> Doc. R-20.

<sup>89</sup> Doc. R-3.

<sup>90</sup> Lukanova Affidavit, paras. 17-18.

<sup>91</sup> *Id.* at para. 18.

85. On May 7, 1998, Pakova transferred the partially renovated rooms on floors 8-10 to the Hotel so that the Hotel could accommodate delegates attending a conference of the European Bank for Reconstruction and Development in Kiev on May 8-12, 1998. The Hotel accepted the work, subject to a promise from Pakova to complete the work following the conference.<sup>92</sup> However, Pakova refused to complete its work due to the Hotel's inability to obtain further funding.

86. On October 16, 1998, Ms. Luganova complained to the President of Pakova, Mr. Kovalenko, about the strained relationship between the Hotel and Pakova, about irregularities in Pakova's documentation, and about its failure to adhere to deadlines set forth in its contract with the Hotel.<sup>93</sup>

87. On December 22, 1998, Ms. Luganova wrote a letter to the "Administration of the President of Ukraine" complaining of Pakova's failure to meet construction deadlines under its contract for floors 8-10.<sup>94</sup> On March 19, 1999, the Hotel and Pakova entered into an Additional Agreement supplementing the November 3, 1997, agreement, which called for the completion of work within three months and affirmed the original contract price of USD 2,776,000. The agreement stated that the Hotel had already made a partial payment of USD 1,074,000, leaving a shortfall of approximately USD 1.7 million.<sup>95</sup>

## 2. 1999 JAA

88. In the spring of 1999, Ms. Luganova approached Mr. Kuess with "an offer to participate" in a new joint "investment" activity for floors 8-10. She gave him a copy of a GEYA report appraising the value of floors 8-10.<sup>96</sup> Mr. Kuess understood that the Hotel could not find

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<sup>92</sup> Doc. R-4.

<sup>93</sup> Doc. R-22.

<sup>94</sup> Doc. R-21.

<sup>95</sup> Doc. R-29; *see also* Claimant's Second Post-Hearing Submission at p. 3, para. II.A (noting that the Hotel was only able to fund \$1 million of the cost of renovation work that in total exceeded \$4.2 million).

<sup>96</sup> Luganova Affidavit, para. 19.

financing to pay Pakova,<sup>97</sup> and that, in exchange for providing USD 1.7 million in financing, Alpha could obtain a one-third interest in the “joint venture” for the three floors.<sup>98</sup>

89. On June 4, 1999, the Hotel, Alpha and Pakova entered into an “Agreement on Joint Investment Activities under the Participation of a Foreign Investor” in connection with floors 8-10 (the “1999 JAA”).<sup>99</sup> Key terms of the 1999 JAA included the following:

- *The Parties*: The parties to the agreement were the Hotel, represented by Ms. Luganova; Alpha, represented by Mr. Kuess; and Pakova, represented by Mr. Pavel Kovalenko.
- *Objectives/Purpose*: The agreement states that the parties “undertake by means of unification of their cash assets, property, interests and efforts to carry out the joint investment activities with further use of the renovated and equipped rooms on the 8th, 9th, and 10th floors of the Hotel.”
- *The Parties’ Obligations*: Alpha contributed USD 1,701,620, which sum was “paid directly to the account of the joint venture in Ukraine.”<sup>100</sup> The Hotel contributed to the joint activity the use of the three floors. Pakova contributed its construction work. According to the agreement, the contributions of the Hotel and Pakova were each considered to be of equivalent value to Alpha’s monetary infusion.
- *Allocation of Profits*: Each of the three partners was to receive one-third of the profits from the operation of the renovated rooms on the three floors. However, the Hotel was obligated to pay Alpha and Pakova each a minimum of USD 50,000 a month. The agreement provided that, if Pakova withdrew from the agreement, profits would be divided 50/50 between the Hotel and Alpha, but with a minimum USD 50,000 monthly payment to Alpha.
- *Duration/Termination*: At the end of the agreement on June 31 [*sic*], 2006, the assets were to be distributed to the remaining partners on a pro rata basis as determined by their respective contributions, “after reimbursement” of the outstanding debts of the joint activities. The agreement created a “separate balance” for the joint activity but also anticipated an early withdrawal by Pakova.

90. In order to appraise the value of the contributions to the 1999 JAA of the Hotel and of Pakova in accordance with applicable Ukrainian law, Ms. Luganova again engaged GEYA,

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<sup>97</sup> Kuess Testimony, Tr. 3, p. 13, lines 6-13; p. 14, lines 6-25.

<sup>98</sup> *Id.* at p. 9, lines 11-20.

<sup>99</sup> Doc. C-132.

<sup>100</sup> Kuess Testimony, Tr. 3, p. 14, lines 6-25.

which appraised the Hotel's contribution at USD \$1,702,000<sup>101</sup> and Pakova's reconstruction work at USD \$1,701,620.<sup>102</sup> Also on June 4, 1999, a further Additional Agreement amending Pakova's construction contract was concluded,<sup>103</sup> which clarified what work on floors 8-10 was finished and what work remained, and specified that Pakova's contribution to the joint activity was its reconstruction effort.

91. Mr. Kuess testified that Alpha had to take out an additional loan from Bank Austria AG in the amount of USD 1,701,620 to meet its obligations under the 1999 JAA.<sup>104</sup> Alpha's investment in the amount of USD 1,701,620 was registered with the Currency Export Board of the Kiev City Administration on July 30, 1999.<sup>105</sup> According to Mr. Kuess, "Alpha's total borrowing for purposes of financing the arrangements with the Hotel as agreed in 1998 and 1999 then totaled USD 3,229,800."<sup>106</sup>

92. According to Ms. Luganova, the 1999 JAA was reviewed by the Ukrainian tax authorities and no problems were found.<sup>107</sup>

### **3. Additional Agreement No. 1 to the 1999 JAA**

93. A little over one month later, on July 14, 1999, the Hotel, Alpha and Pakova agreed to permit Pakova to end its participation in the 1999 JAA.<sup>108</sup> On the same day, the parties executed "Additional Agreement No. 1" to the 1999 JAA, which memorialized Pakova's withdrawal.<sup>109</sup>

94. The agreement modified the 1999 JAA's payment provisions so as to reflect Pakova's withdrawal. It also confirmed that the Hotel and Alpha would share equally in profits but with a USD 50,000 minimum monthly payment to Alpha. In addition, the Hotel was entrusted with the

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<sup>101</sup> Doc. C-133.

<sup>102</sup> Doc. C-131; Luganova Affidavit, para. 21; Affidavit of Ludmila Trusova, para. 12 ("Trusova Affidavit").

<sup>103</sup> Doc. R-30.

<sup>104</sup> Kuess Affidavit, para. 26; *see also* Doc. C-176; Doc. C-139.

<sup>105</sup> Memorial, pp. 8-9, paras. 24-25.

<sup>106</sup> Kuess Affidavit, para. 26.

<sup>107</sup> Luganova Affidavit, para. 22.

<sup>108</sup> Doc. C-137.

<sup>109</sup> Doc. C-138.

responsibility “to perform the state registration” of the Additional Agreement, which it did on July 30, 1999.<sup>110</sup>

95. On July 15, 1999, Alpha transferred USD 1,701,620 to the account of the 1999 JAA<sup>111</sup> and on July 23, 1999, this sum was transferred from the 1999 JAA account in Ukraine to Pakova's bank account in Cyprus.<sup>112</sup> On August 12, 1999, the State Committee for Tourism approved the 1999 JAA as amended by the Additional Agreement of July 14, 1999.<sup>113</sup>

#### **D. Floors 4-7 and the Rest of the Hotel**

96. The Hotel was also interested in renovating floors 4-7, but it lacked the money to do so.<sup>114</sup> Once again, Ms. Luganova approached Alpha for assistance.<sup>115</sup> According to Mr. Kuess, while Alpha and the Hotel did not have a signed agreement to conduct the renovations, “Alpha financed the renovation of the Munich Bar on the fourth floor of the Hotel, the night bar on the second floor of the Hotel, and the Wellness Center in the Hotel basement . . . . The reason that I was willing to have Alpha do so was . . . that I understood that Alpha and SE Dnipro Hotel were engaged in a partnership which had as its object the ultimate renovation of the entire Hotel.”<sup>116</sup> Mr. Kuess admitted, however, that “no one could promise that Alpha would in fact end up owning the hotel.”<sup>117</sup> Ms. Luganova testified that the State Tourist Administration had ignored her proposals to form a joint venture with Alpha to renovate these floors.<sup>118</sup> The parties have not explained how the renovation of floors 4-7 is relevant to this dispute. However, at a minimum, the events surrounding the renovation of floors 4-7 indicate that the management of the Hotel and Claimant continued to have a close working relationship and that the management was potentially interested in deepening that relationship.

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<sup>110</sup> Doc. C-140.

<sup>111</sup> Doc. R-11.

<sup>112</sup> Doc. R-12.

<sup>113</sup> Doc. C-205.

<sup>114</sup> Trusova Affidavit, paras. 15-16.

<sup>115</sup> Luganova Affidavit, para. 27.

<sup>116</sup> Kuess Supplemental Affidavit, para. 10.

<sup>117</sup> *Id.* at para. 9.

<sup>118</sup> Luganova Affidavit, para. 27.

### **E. Suspension of Payments Under the 1998 JAA**

97. In 2000, it became apparent that the Hotel could not complete the renovation of the entire Hotel without additional funding. According to Ms. Luganova, “With Pakova’s departure, I became concerned that Alpha too might decide to exit the joint activity. This was a time of deep economic crisis . . . Domestic capital was scarce, and foreign investors had largely fled the Ukraine. Alpha was the only reputable entity that I could locate to invest in what was a State owned property.”<sup>119</sup> In addition, the Hotel faced a number of unanticipated expenses, including the need for a new digital telecommunications system, which it could not cover on its own.<sup>120</sup>

98. In order to help the Hotel fund the necessary upgrades and repairs, on September 1, 2000, the Hotel and Alpha executed “Additional Agreement No. 1” to the 1998 JAA.<sup>121</sup> Under the terms of the agreement, the minimum monthly payment due to Alpha under the 1998 JAA would be suspended until July 1, 2006. In addition, commencing from September 2000, the minimum monthly payment due to Alpha was to be increased from USD 35,000 to USD 50,000.<sup>122</sup> During the suspension period from September 1, 2000 - July 1, 2006, the monthly payments would continue to accrue but would not be paid until the end of the suspension period. The minimum monthly payments of USD 50,000 would continue to be paid through the end of the term of the 1998 JAA, which was prolonged from July 3, 2004, to June 30, 2015.

99. The payment holiday under the 1998 JAA did not extend to the 1999 JAA. Alpha continued to receive USD 50,000 per month under the 1999 JAA until June 2004, when payments ceased, as discussed below.<sup>123</sup>

100. Respondent argues that the extension of the term of the 1998 JAA “up to 2015 was at least unfounded[,] if not illegitimate.”<sup>124</sup> Respondent notes that the original term of any alleged “joint activity” was only 10 years. According to Respondent, six years elapsed before any

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<sup>119</sup> *Id.* at para. 23.

<sup>120</sup> *Id.* at para. 24.

<sup>121</sup> Doc. C-143.

<sup>122</sup> Kuess Affidavit, paras. 30-31; Luganova Affidavit, para. 25.

<sup>123</sup> Luganova Affidavit, para. 26.

<sup>124</sup> Counter-Memorial, para. 55.

suspension took place, meaning that – post suspension – the arrangement should only have continued for another four years.<sup>125</sup> Respondent does not explain why the agreed extension is impermissible. The Tribunal does not find the extension itself unreasonable in light of Alpha’s agreement to suspend the monthly payments for six years. However, as explained in section VIII below, the Tribunal concludes that the terms of the extension, and in particular the minimum monthly payment provisions, are legally invalid under the later January 1, 2004, Ukrainian Civil Code and cannot stand due to the fact that they insulated the Claimant from bearing its share of the expenses and deprived the Hotel of its share of the profits of the joint activity.

#### **F. “Corporatization” of the Hotel**

101. On July 12, 2001, the Hotel was transferred from the list of State-owned properties not subject to privatization to the list of such properties not subject to privatization but subject to “corporatization.”<sup>126</sup> On February 13, 2003, the Ministry of Economy approved the Hotel as a property subject to “corporatization.”<sup>127</sup> On February 25, 2003, the State Tourism Administration issued Order No. 19 requiring the “corporatization” or reorganization of the Hotel into “Open Joint Stock Company ‘Dnipro Hotel’” (the “OJSC Hotel”).<sup>128</sup>

102. On February 28, 2003, the corporatization process commenced.<sup>129</sup> A “commission” was formed to “appraise the assets” of the Hotel, to “draft articles of association of the newly established” OJSC Hotel and to “suggest the placing of shares.”<sup>130</sup> During this process, a “valuation” of the Hotel’s “non-current assets” was performed by GEYA pursuant to State Tourist Administration Decree No. 57 of March 27, 2003.<sup>131</sup> GEYA’s appraisal was concluded on June 5, 2003, and subsequently “approved” by the Corporatization Commission on July 23, 2003.<sup>132</sup> A letter from the State Property Fund of July 14, 2003, to the State Tourist

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<sup>125</sup> *Id.*

<sup>126</sup> Doc. C-21.

<sup>127</sup> Doc. C-27.

<sup>128</sup> Doc. C-28.

<sup>129</sup> *Id.*

<sup>130</sup> Request for Arbitration, para. 12 (“Request”).

<sup>131</sup> *See* Memorial, p. 16, para. 38; *see also* Doc. C-149-04 (portion of GEYA report titled “Consolidated Report No. 2” noting that appraisal was conducted pursuant to Order No. 57 of the “State Tourist Administration of Ukraine” dated March 27, 2003).

<sup>132</sup> Memorial, p. 16, para. 38.



Administration “acknowledge[ed] and approv[ed] the report concerning the value of Hotel assets.”<sup>133</sup> The results of the appraisal were incorporated into the Corporatization Commission’s Act of Appraisal on November 23, 2003.<sup>134</sup>

103. The parties spent considerable time and effort presenting arguments on the methodology used in GEYA’s appraisal and the consequences of the State Tourist Administration’s approval of that appraisal. According to Ms. Trusova, who had been the general director of GEYA at the time the appraisal was conducted, the appraisal covered only the non-current assets of the Hotel, including an inventory of physical items, fixed assets, intangible assets, and long-term financial investments.<sup>135</sup>

104. Ms. Trusova’s initial affidavit stated that the GEYA report “did not make provision for and did not include the guaranteed fixed minimum amounts due monthly to Alpha under the two joint activity agreements . . . .”<sup>136</sup> Ms. Trusova clarified and corrected her testimony during the Hearing. There, she indicated that there was an error in the translated version of her affidavit, which should have stated that the GEYA appraisal did not take into account the “full amount” of the monthly payment owed to Alpha.<sup>137</sup> Ms. Trusova clarified that (1) with respect to the 1998 JAA, the appraisal reflected a 50/50 split of the forecast profits through 2007, and a minimum monthly payment to Alpha of USD 35,000 from 2007 onward; and (2) with respect to the 1999 JAA, the appraisal reflected a minimum monthly payment of USD 35,000.<sup>138</sup> According to Ms. Trusova, the Hotel’s management also created an “Acquisition Balance Sheet” which was to reflect the Hotel’s long-term liabilities and expenses, though again it did not reflect all of the minimum monthly payments owed to Claimant.<sup>139</sup>

105. As explained below, in its argumentation on the merits, Claimant asserts that it was entitled not only to the minimum monthly payments specified in the agreements but also, upon

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<sup>133</sup> Doc. C-150; Testimony of Adrii Omelchenko, Tr. 5, p. 90, lines 10-18 (“Omelchenko Testimony”).

<sup>134</sup> Doc. C-152; Trusova Affidavit, para. 24.

<sup>135</sup> Trusova Affidavit, para. 20.

<sup>136</sup> *Id.* at para. 21.

<sup>137</sup> Testimony of Ludmila Trusova, Tr. 3, p. 64, lines 2-7, (“Trusova Testimony”).

<sup>138</sup> *See* Tr. 3, p. 64, lines 19-24; p. 107, lines 20-25; pp. 120-23.

<sup>139</sup> *See* Trusova Affidavit, paras. 22-23.

termination of the joint activity, to repayment of its initial contribution and a share of the value of the joint activity. (Claimant did not, however, include in its damages claim any amount for return of its original contribution). The parties agree that the appraisal did not reflect any ownership rights Claimant may have had in the joint activity apart from the reduced amount of minimum monthly payments as discussed above. Respondent, in fact, was explicit on this point, stating that “neither the separate balance sheets of the joint activity, nor the balance sheets of the Hotel itself have ever (both before the corporatization and afterwards) reflected, or in principle should have reflected, any of these obligations.”<sup>140</sup>

106. The parties presented extensive argumentation at the Hearing on the question of why the appraisal did not reflect the minimum monthly payments of USD 50,000 specified in the 1998 JAA (as amended) and the 1999 JAA. Ms. Trusova testified that she was acting on the instructions of Ms. Liliya Timoschik, who at the time was the deputy head of the State Property Fund.<sup>141</sup>

107. According to Ms. Trusova, GEYA’s original draft appraisal report reflected a USD 50,000 monthly payment to Claimant under both the 1998 and 1999 JAAs. She indicated that this would have been the approach she would have taken if the Hotel had been a private enterprise or if she had not received further instructions from the State Property Fund.<sup>142</sup> However, according to Ms. Trusova, “the representatives of the state property fund proved us [*sic*] that this was harmful for the state enterprise, so the state property fund which is supposed to protect the state interests couldn’t agree with that attitude.”<sup>143</sup> Furthermore, she testified, “Ms. Timoschik asked [her] why only a state enterprise should carry the burden of . . . a diminution in profits [due, *e.g.*, to costs associated with the reconstruction effort]. The investor, she said, had

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<sup>140</sup> Respondent’s First Post-Hearing Submission, para. 53. Respondent also asserts that the minimum monthly payments were not included in the balance sheets, though, as noted, Ms. Trusova testified that they were included, but at different levels than specified in the contracts. Respondent further states that “[t]here are no liabilities of the Hotel to be reflected in line 7 of the Act of Appraisal or in line 470 of the [Acquisition Balance Sheet] as long-term obligations. The obligation to distribute the terminal value of the joint activity may arise only on the date of termination of the joint activity, when all balance sheets are closed and liquidated. The regularly arising obligation to pay minimum amount of profit to Alpha, which is performed monthly (usually within a few days), cannot be considered as a long-term obligation.” *Id.* at para. 54.

<sup>141</sup> *See, e.g.*, Tr. 3, pp. 60-61, and pp. 82-83.

<sup>142</sup> *Id.* at p. 69, lines 8-25; p. 73, lines 16-18; p. 122, lines 13-23; p. 123, lines 10-16.

<sup>143</sup> *Id.* at p. 69, lines 2-6.

to carry its part of it, because this is a force majeure circumstance.”<sup>144</sup> According to Ms. Trusova, “the representative of the state property fund considered that this agreement [requiring a USD 50,000 monthly payment] has been signed without taking into account the interest of the state enterprise.”<sup>145</sup>

108. Ms. Trusova apparently felt compelled to follow the instructions of Ms. Timoschik. Ms. Trusova testified that “[i]t’s not an instruction; it’s a requirement” to follow the directives of the State Property Fund.<sup>146</sup> She stated that, “we weren’t advised to do these corrections; we were asked to do these corrections. It was obligatory, compulsory for us to do it.”<sup>147</sup> At the same time, however, Ms. Trusova stated that “I can’t say it was Ms. Timoschik who told me to put it inside the \$35,000. I had the right to put inside what I wanted. I managed to tell them that 35,000 will be the minimum, I couldn’t convince [the State Property Fund] to go higher than [USD] 35,000.”<sup>148</sup> Regardless of whether Ms. Trusova was actually compelled to follow the course she did, at a minimum, she apparently believed that the appraisal would have been rejected if she did not follow the instructions of the State Property Fund.<sup>149</sup>

109. In its first post-hearing brief, Respondent submitted a letter from Ms. Timoschik, in which she stated that she could not recall any conversations with Ms. Trusova “concerning contents and methodology of the Appraisal Report” and “therefore cannot confirm the correctness of this testimony.” She also stated that any comments of the State Property Fund “can not be considered obligatory by the appraisers, since this would come into conflict with the principle of independence of the appraisals.”<sup>150</sup>

110. On August 13, 2003, the State Tourist Administration issued Decree No. 103, which reorganized the Hotel into a State-owned Open Joint Stock Company or OJSC.<sup>151</sup> On the same date, the State Tourist Administration approved the Charter (*i.e.*, articles of association) of the

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<sup>144</sup> *Id.* at p. 60, lines 15-19.

<sup>145</sup> *Id.* at p. 72, line 25; p. 73, lines 1-3.

<sup>146</sup> *Id.* at p. 60, line 8.

<sup>147</sup> *Id.* at p. 69, lines 12-14.

<sup>148</sup> *Id.* at p. 120, lines 24-25; p. 121, lines 1-3.

<sup>149</sup> *Id.* at p. 131, lines 6-9.

<sup>150</sup> Doc. R-79.

<sup>151</sup> Doc. C-30.

OJSC Hotel.<sup>152</sup> On August 18, 2003, a certificate of registration was issued for the OJSC Hotel.<sup>153</sup>

111. The Charter<sup>154</sup> stipulates that the OJSC Hotel is “a legal successor of property rights and obligations of the public enterprise ‘Dnipro Hotel’” and that its property “includes fixed assets and circulating assets as well as valuables[,] the cost of which is reflected in the Company[’s] [*i.e.*, the Hotel’s] balance.” The Charter designates the State, as represented by the State Tourist Administration, as the founder and shareholder. The State Tourist Administration is given authority to “submit the candidates of its representatives to [the] supervisory board,” “participate in the Company[’s] business management,” determine the procedure for profit and loss distribution, appoint and dismiss “the head of the board of directors of the Company,” and make decisions on “termination of Company business.”

112. The Charter appointed Ludmila Luganova as the “first head of the board of directors.”<sup>155</sup> It also established a supervisory board that would exercise “control over the operation of the Company board of directors for the purpose of protection of the interests of the state . . . .” The supervisory board was to have five members, one each from the State Tourist Administration, the State Property Fund, the Kiev city administration, the “bank establishment,” and the Hotel. According to Mr. Melnikov, however, a representative from “Pechersky district administration” sat on the board instead of a representative from the Kiev city administration, and a private lawyer paid by the Hotel chaired the committee and took the place of the representative of the State Tourist Administration.<sup>156</sup>

113. As a consequence of this reorganization, on August 29, 2003, the Hotel and Alpha entered into another Additional Agreement to the 1999 JAA that recognized the OJSC Hotel as the successor to and assignee of the previous State Enterprise Hotel.<sup>157</sup> This Additional Agreement expanded the “joint investment activity” to include “other lodgments” of the OJSC

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<sup>152</sup> *Id.*

<sup>153</sup> Omelchenko Testimony, Tr. 5, p. 45, lines 15-25.

<sup>154</sup> Doc. C-155.

<sup>155</sup> *Id.*

<sup>156</sup> Hearing on the Merits, Transcript Day 4, pp. 41-43 (“Tr. 4”).

<sup>157</sup> *See* Doc. C-157.

Hotel beyond floors 8-10.<sup>158</sup> It also confirmed the minimum monthly payment to Alpha of USD 50,000. The Additional Agreement also extended the termination date under the 1999 JAA from “June 31 [*sic*], 2006” to “June 31 [*sic*], 2015.” According to Ms. Luganova, the State Tourist Administration approved this extension.<sup>159</sup> On September 26, 2003, the Hotel and Alpha entered into another agreement, which recognized the OJSC Hotel as successor in interest to the rights and obligations of the prior State Enterprise Hotel under the 1998 JAA.<sup>160</sup>

### **G. The “Reinvestment”**

114. According to Ms. Luganova, due to the continued suspension of payments to Alpha under the 1998 JAA, the Hotel would have had to incur additional tax payments and penalties, which it could not afford to pay. In order to resolve the problem, the Hotel and Alpha agreed to treat USD 447,569.09 of the amount owed to Alpha as a “reinvestment.”<sup>161</sup> Mr. Kuess confirmed this explanation.<sup>162</sup>

115. On November 19, 2003, an “Additional Agreement No. 3/03” to the 1998 JAA was concluded whereby “funds” accruing to Alpha from September 1, 2000, to July 1, 2003, in the amount of USD 447,569 were to be treated as a “reinvestment” by Alpha.<sup>163</sup> Claimant asserts that, in exchange for the reinvestment, the parties agreed to extend the term of the 1999 JAA until June 30, 2015, with minimum monthly payments to Claimant during that time of USD 50,000.<sup>164</sup>

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<sup>158</sup> *Id.*

<sup>159</sup> Luganova Testimony, Tr. 2, p. 72, lines 8-16.

<sup>160</sup> Doc. C-158.

<sup>161</sup> Luganova Affidavit, paras. 32-33.

<sup>162</sup> Kuess Affidavit, para. 32.

<sup>163</sup> Doc. C-161; *see also* Memorial, p. 10, para. 28 (noting that this reinvested sum of USD 447,569.09 was registered with the Ukrainian authorities on December 25, 1998).

<sup>164</sup> Kuess Testimony, Tr. 1, p. 156, lines 13-20 (“Madam Luganova has explained to me with counsel that this amount was worth \$450,000. This amount has been integrated also into the joint venture capital by Alpha, in spite of the fact that Alpha had \$1.8 million due under 2006. And for this precise reason the agreement has been prolonged until 2015”). Claimant’s First Post-Hearing Submission at p. 8 (Claimant states that the “agreement to extend the term of the 1999 JAA (*see* Doc. C-157) from 2006-2015 [was] in return for Alpha’s agreeing to trade the debt owed to it under the 1998 JAA (*see* Doc. C-143) as a result of over three years of suspended guaranteed minimum monthly returns for a ‘reinvestment’ equal to only a small percentage of that indebtedness (*see* Doc C-161)”).

116. The precise effect of the reinvestment with respect to the parties, rights and obligations under the 1998 JAA is not clear. For example, if Claimant were entitled to USD 50,000 per month, then the amount owing to it for the period September 1, 2000 – July 1, 2003 would have been USD 1.7 million. It is not clear whether this amount was reduced to USD 447,569, whether the reinvestment qualified as an additional contribution under the JAA by Claimant, whether the USD 447,569 amount was still owed to Claimant after the suspension period or upon termination of the contract, or whether Claimant was still owed the USD 1.7 million and was to be paid at some point in the future. It does not appear that Claimant included any amount for this reinvestment in its damages claim.

## **H. Transfer of Authority to the State Administration of Affairs**

117. Based on a February 18, 2004, order from President Leonid Kuchma,<sup>165</sup> the Cabinet of Ministers of Ukraine issued Order No. 196 on March 31, 2004, which transferred authority to manage the State's ownership of the OJSC Hotel from the State Tourist Administration to the State Administration of Affairs.<sup>166</sup>

## **I. Subsequent Events Including the Cessation of Payments to Alpha**

### **1. MCRO Audits**

118. In the spring of 2004, the State Administration of Affairs asked the State Main Control and Revision Office ("MCRO") to raid the premises of the Hotel.<sup>167</sup> The MCRO seized all documentation related to the financial activities of the Hotel, including in connection with the joint activities.

119. On May 25, 2004, representatives from MCRO issued an audit of Alpha's relationship with the Hotel that confirmed that "the Investor [Alpha] invested USD \$1,701,620" under the 1999 JAA but found the payment to Pakova of this amount unlawful under the FIL.<sup>168</sup> The

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<sup>165</sup> Doc. C-32.

<sup>166</sup> Doc. C-51; Request, para. 17.

<sup>167</sup> Luganova Affidavit, para. 45.

<sup>168</sup> Doc. C-190, pp. 8-9.

MCRO audit report was critical of the JAAs and the Hotel's implementation of these agreements, asserting violations of numerous laws and accounting standards.<sup>169</sup>

120. Ms. Luganova was removed from her position as Chair of the Board of Directors of the Hotel in early June 2004.<sup>170</sup> According to Mr. Melnikov, she requested another audit by MCRO,<sup>171</sup> which took place in July. On or about July 1, 2004, the MCRO issued a "Certificate,"<sup>172</sup> which reported that Alpha had made an investment of USD 1,701,620 under the 1999 JAA. The MCRO concluded, however, that the Hotel "used, without proper justification, cash funds (investment)" in the amount of USD 1,701,620 "in order to compensate" Pakova. It further concluded that Pakova overcharged with respect to certain materials costs and improperly applied an adjustment factor, and that the value of the performed work was only USD 395,000 rather than USD 1.7 million.

121. According to Mr. Melnikov, MCRO's findings were sent to the General Prosecutor's office and served as the basis for initiating criminal proceedings against the former management of the Hotel on October 20, 2004.<sup>173</sup> The criminal investigation was terminated in 2005, based on findings by the senior investigator that there had been no wrongdoing by Hotel management and "no facts of damage caused to the state interests."<sup>174</sup> According to Ms. Luganova, the investigation was later renewed.<sup>175</sup>

## **2. 2004 and Subsequent Charters**

122. In the meantime, on May 27, 2004, a new Hotel Charter was approved by the State Administration of Affairs. The Charter refers to the February 18, 2004, "Decree of the President of Ukraine" and to the March 31, 2004, "Decree of the Cabinet of Ministers."<sup>176</sup> The State, as represented by the State Administration of Affairs as sole shareholder, was designated as the

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<sup>169</sup> See generally Doc. C-190.

<sup>170</sup> Kuess Affidavit, para. 35 (early June); Testimony of Mr. Volodymyr Melnikov, Tr. 4, p. 67, lines 16-17 ("Melnikov Testimony") (stating that Ms. Luganova was fired sometime around June 10-12, 2004).

<sup>171</sup> Tr. 4, p. 63, lines 3-15.

<sup>172</sup> Doc. C-194.

<sup>173</sup> Tr. 4, p. 66, lines 9-20.

<sup>174</sup> Doc. C-173.

<sup>175</sup> Luganova Affidavit, para. 45.

<sup>176</sup> Doc. C-169.

“supreme authority” responsible for, among other things, the procedure of net profit distribution and loss. Two more representatives of the State Administration of Affairs were added to the “Supervisory Board,” which now included a total of seven members, five of whom would be from the Ukrainian Government. On July 29, 2004, an eighth member was added from the Ministry for Economics and European Integration.<sup>177</sup>

123. On January 25, 2006, yet another Charter for the Hotel was executed. This Charter states that the “Supreme authority” of the Company is “exercised by the State Administration of Affairs as the sole shareholder.”<sup>178</sup> The Charter also provided for a board of directors.<sup>179</sup>

124. Another Charter was issued on October 3, 2007.<sup>180</sup> This one provided that the OJSC Hotel “is a national object”<sup>181</sup> and that it shall “ensure performance by the State of its functions, *i.e.*: It shall take part in national activities . . . [and] render services to citizens and members of Ukrainian and foreign governmental delegations, who are on temporary duty to representative offices of executive and legislative authority.”<sup>182</sup> The “general meeting of shareholders” was designated as the “Supreme authority,” with the sole shareholder as the State Administration of Affairs.<sup>183</sup> Like previous charters, the October 3, 2007, Charter also provided for a board of directors.<sup>184</sup>

### 3. Suspension of Payments in June of 2004

125. On June 29, 2004, the new chairman of the Hotel, Mr. Grigorenko, notified Mr. Kuess by letter of the transfer of ownership of the Hotel to the State Administration of Affairs and assured Alpha that the JAAs remained in effect.<sup>185</sup> Mr. Grigorenko “confirm[ed] the conditions of our collaboration determined in the contracts . . . as unchangeable.”<sup>186</sup> As it turned out, however,

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<sup>177</sup> *Id.* at p. 13.

<sup>178</sup> Charter of Open Joint Stock Company Dnipro Hotel of January 25, 2006, Doc. C-184, p. 9, para. 10.

<sup>179</sup> *Id.* at p. 10, para. 11.

<sup>180</sup> Charter of Open Joint Stock Company Dnipro Hotel of October 3, 2007, Doc. C-186.

<sup>181</sup> *Id.* at p. 6, para. 4.

<sup>182</sup> *Id.* at p. 2.

<sup>183</sup> *Id.* at para. 10.

<sup>184</sup> *Id.* at para. 11.

<sup>185</sup> Kuess Affidavit, para. 35; Grigorenko letter of June 29, 2004, Doc. C-196.

<sup>186</sup> Doc. C-196.



Alpha received its last payment under the 1999 JAA in June 2004.<sup>187</sup> No further payments were made under the 1998 JAA after the suspension of payments in September 2000.

126. At Alpha's request,<sup>188</sup> the Austrian embassy contacted various Ukrainian authorities, including the State Administration of Affairs.<sup>189</sup> On September 17, 2004, the State Administration of Affairs responded,<sup>190</sup> and suggested that the Austrian Embassy should contact the management of the Hotel directly. According to Mr. Kuess:

Throughout the remaining months of 2004 and the first half of 2005, Alpha's inquiries to the new management . . . and to the State Administration of Affairs in its capacity as the managing authority of OJSC Dnipro Hotel were ignored. Since the second quarter of 2004, Alpha has never been given the opportunity to review a separate balance (financial statement) of either joint activity, has never been provided with any information regarding the joint activities, and has received no profit distribution on account of either of the joint activities . . . .<sup>191</sup>

127. After additional pleas to the Ukrainian government and the management of the Hotel, Mr. Kuess began to discuss potential legal action with Dr. Specht.<sup>192</sup>

#### **4. Attempted Transfer of the Hotel to Dnipro Elite and Related Events**

128. In late 2004, the State Administration of Affairs attempted to privatize the Hotel by transferring "the real property" of the Hotel building into the statutory capital of a limited liability company, Dnipro Elite LLC. A "Real Property Acceptance Certificate" recorded the transfer on December 28, 2004, citing as authority an October 1, 2004, decree of the Head of the State Administration of Affairs.<sup>193</sup>

129. According to Ms. Luganova, Dnipro Elite was headed by the leader of a criminal ring, Mr. Kurochkin, who "was killed later on during the investigation. He practically occupied the

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<sup>187</sup> See e.g., Request, para. 19; Kuess Affidavit, para. 36; Affidavit of Sabine Isopp, para. 6 ("Isopp Affidavit").

<sup>188</sup> Kuess Affidavit, para. 37.

<sup>189</sup> See Doc. C-168; Doc. C-177.

<sup>190</sup> Doc. C-168.

<sup>191</sup> Kuess Affidavit, para. 36.

<sup>192</sup> Kuess Testimony, Tr. 3, p. 39, lines 10-25; p. 40, lines 1-20.

<sup>193</sup> Doc. C-171.

hotel, constructed a bunker, whole bunker in the yard of the hotel. And there were criminal quarrels going on because of the state property.”<sup>194</sup>

130. During October and November 2004, the so-called “Orange Revolution” took place in Ukraine, and President Kuchma’s term as the President of Ukraine ended on January 23, 2005.

131. On February 16, 2005, a “Special Control Commission of Privatization Issues” of the Ukrainian Parliament called for the invalidation of the “hidden privatization” of all of the Hotel’s assets, *i.e.*, the transfer of the Hotel to Dnipro Elite.<sup>195</sup> This Commission advised the new President to cancel the October 1, 2004, Decree.<sup>196</sup> The Commission also referred the matter to the General Prosecutor’s Office. As a result, “Dnipro Elite was liquidated and the attempt to privatize OJSC Dnipro Hotel was abandoned.”<sup>197</sup>

132. Ms. Luganova returned as Chairman of the Board of the Hotel in March 2005, only to discover that “breaches of the joint activity agreements with Alpha had [occurred] in the period after [her] removal.”<sup>198</sup> On behalf of the Hotel, she filed a complaint with the Pechersky District Court of Kiev against the State Administration of Affairs, seeking to annul Dnipro Elite’s registration. Soon thereafter, Ms. Luganova was again removed from her position.<sup>199</sup>

133. On April 14, 2005, an accounting firm, Ask Audit, issued a report on the accounts of the joint activities and concluded that the management of the Hotel by the State Administration of Affairs had resulted in the misappropriation of funds from these accounts.<sup>200</sup> On May 23, 2005, the Kiev Economic Court formally voided the attempted unlawful privatization of the Hotel.<sup>201</sup>

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<sup>194</sup> Luganova Testimony, Tr. 2, p. 137, lines 5-9.

<sup>195</sup> Doc. C-172.

<sup>196</sup> *Id.*

<sup>197</sup> Luganova Affidavit, para. 47.

<sup>198</sup> *Id.* at para. 48.

<sup>199</sup> *Id.*

<sup>200</sup> *See* Doc. C-191; Luganova Affidavit, para. 48.

<sup>201</sup> Doc. R-31.

134. Claimant has not asserted claims based on the events surrounding the attempted transfer of the Hotel to Dnipro Elite.

## 5. Alpha Begins Further Negotiations

135. On July 7, 2005, the State Administration of Affairs responded to a complaint about Alpha's treatment sent by the Trade Department of the Embassy of Austria in Kiev to the Ukrainian Ministry of Foreign Affairs.<sup>202</sup> The letter stated that criminal proceedings had been initiated against the Hotel's officers and that "any settlements may now seriously complicate execution of decisions by inspection authorities."<sup>203</sup>

136. Alpha and the Hotel held several meetings in August, September and October of 2005. According to Mr. Kuess, the Hotel notified him in October "that the obligations of OJSC Dnipro Hotel under the joint activity agreement had not been performed because the legal base of the joint activities and the legitimacy of profit distribution from the joint activities were being examined."<sup>204</sup>

137. According to the minutes of a meeting held on October 15, 2005, representatives of Alpha and the Hotel concluded that, since June 2004, the "OJSC Dnipro Hotel . . . has really suspended all payments" to Alpha and had failed to provide to Mr. Kuess "information on leadership change and progress of joint activities."<sup>205</sup> The minutes also confirm the Hotel's failure to inform Mr. Kuess of the "transfer" of the "Hotel property complex" to Dnipro-Elite and the later "invalidation of such transfer." The minutes state that, "Investments made pursuant to such Agreements [the JAAs] were registered in procedure prescribed by the existing legislation of Ukraine." The minutes also indicate that representatives from the Hotel had explained that payments had been suspended to allow time to assess the size and validity of the

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<sup>202</sup> Doc. C-177.

<sup>203</sup> *Id.* This letter echoed the language used in an earlier response from the State Administration of Affairs to the Austrian Trade Department on September 17, 2004, which stated that the MCRO inspection had discovered "certain violations of current legislation . . . in particular with regard to unreasonable recalculation of investment compensation, charges and re-computation of investors' dividends . . ."; that the matter has been referred to the General Prosecutor's Office for legal action; and that "any settlement" would complicate the process. Doc. C-168.

<sup>204</sup> Kuess Affidavit, paras. 38-39.

<sup>205</sup> Doc. C-181.

contributions to the joint activity and the legality of the profit distributions. The minutes were signed on behalf of the Hotel by its then Director, Mr. Vladimir Melnikov.

138. On December 5, 2005, the Specht Firm sent a letter to the OJSC Hotel in which it summarized the alleged facts in the case and alleged breach of contract by the Hotel.<sup>206</sup> The Specht Firm's letter asserted that "the ongoing use of Alpha's investment into the Hotel" by the OJSC Hotel "amounts to an expropriation (illegal taking) as defined" in the UABIT. The letter referred to an earlier letter of November 16, 2005, in which it sent a "first summary of the facts" in the case to Austria's Ministry of Foreign Affairs.

139. On December 16, 2005, representatives of Alpha and the Hotel met again in an effort to resolve the dispute. The draft minutes of the meeting state that the management of the Hotel suggested that the 1998 JAA and the 1999 JAA be abandoned.<sup>207</sup> They further asked Alpha to renounce "any and all property rights for any assets, provided by the foreign investor for participation in joint activities . . . in favour of the Hotel," and that the parties consider the 1998 JAA terminated from September 1, 2000, and the 1999 JAA terminated from February 1, 2004.<sup>208</sup> Alpha refused to agree and did not sign the minutes of the meeting.<sup>209</sup>

140. On February 21, 2006, the Austrian Trade Department forwarded to Alpha a January 12, 2006 letter from the new management of the Hotel to the Austrian Embassy.<sup>210</sup> The letter was signed by "V.A. Tocheny, First Representative Chief Executive of the open stock company Dnipro Hotel." The letter stated that Alpha had entered into the JAAs "with the intention – contrary to laws – to take ownership (of the profits) of a corporation – from a government sector of the Ukrainian economy." The letter also referred to "illegal transfers of currency from the Ukraine abroad" as well as to the initiation of criminal proceedings on October 20, 2005 by the "State Attorney of the City of Kiev." The letter took the position that "from a judicial point of

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<sup>206</sup> Doc. C-206.

<sup>207</sup> Doc. C-182.

<sup>208</sup> *Id.*

<sup>209</sup> See Affidavit of Vladimir Ryzhy, paras. 6-7 ("Ryzhy Affidavit") (noting that "Representatives of Alpha did not give consent to terminate the agreements on joint activity" and that the meeting minutes are "unsigned"); Kuess Affidavit, para. 40.

<sup>210</sup> Doc. C-185.

view, even without a court decision, Dnipro Hotel had legal reasons not to keep the useless agreements – meaning the investment contracts . . . .”<sup>211</sup> Attached to the Hotel’s response was an analysis as to why the JAAs were regarded as illegal and void.

141. On March 2, 2006, the Specht Firm wrote again to the OJSC Hotel listing various allegations of contract breaches.<sup>212</sup> On April 4, 2006, Hotel management responded,<sup>213</sup> and on May 22, 2006, the Specht Firm wrote again.<sup>214</sup> On May 31, 2006, the Specht Firm indicated it would travel to Kiev to inspect the Hotel’s books and accounts.<sup>215</sup>

142. The Hotel and Alpha met in Kiev on June 9, 2006.<sup>216</sup> Alpha claimed its right to inspect the books and accounts under the 1998 JAA and the 1999 JAA, but the Hotel claimed that all such records had been seized by the Public Prosecutor’s Office for use in its criminal investigation.

143. Local counsel for Alpha sent letters to the Hotel on July 4 and August 11, 2006 repeating prior requests for information, but without response.<sup>217</sup> On August 14, 2006, local counsel for Alpha sent yet another letter, complaining of the lack of response to its earlier letters, of the Hotel’s failure to sign the memorandum of the meeting of June 9, 2006, and of the lack of any “constructive efforts” by the Hotel to settle the dispute with Alpha.<sup>218</sup>

## **6. Local Court Proceedings and Further Events**

144. It appears that sometime in 2006, the management of the Hotel wrote to the Public Prosecutor of Kiev asking that an action be brought to invalidate the 1998 and 1999 JAAs.<sup>219</sup>

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<sup>211</sup> *Id.* (emphasis omitted).

<sup>212</sup> Doc. C-206.

<sup>213</sup> *Id.*

<sup>214</sup> *Id.*

<sup>215</sup> *Id.*

<sup>216</sup> *Id.*

<sup>217</sup> *Id.*

<sup>218</sup> *Id.*

<sup>219</sup> Doc. R-32.

145. On August 21, 2006, the Deputy Public Prosecutor for the City of Kiev, on behalf of the Cabinet of Ministries of Ukraine and the State Administration of Affairs, filed a claim with the Commercial Court of Kiev seeking to invalidate the Joint Activity Agreement of 1999.<sup>220</sup> The action was filed on behalf of the State Administration of Affairs as the sole shareholder against the Hotel, Pakova, and Alpha. According to Mr. Kuess, “Alpha was not even notified of that proceeding until October 2006.”<sup>221</sup>

146. On September 14, 2006, Alpha initiated a civil case against the Hotel in the Kiev Economic Court, alleging breaches of the 1998 and 1999 JAAs.<sup>222</sup> Alpha’s “statement of claim” referred to the suspension in payments and the failure to deliver reports and other information as contractually required.<sup>223</sup>

147. On September 25, 2006, the Economic Court accepted Alpha’s claim for consideration.<sup>224</sup> On October 31, 2006, the Economic Court stopped the proceedings in Alpha’s case based upon a motion by the OJSC Hotel invoking the pending proceedings instituted by the Kiev Prosecutor’s Office concerning the 1999 JAA.<sup>225</sup> On December 6, 2006, Alpha appealed this decision, arguing that its case should at least proceed regarding the 1998 JAA.<sup>226</sup>

148. On November 5, 2007, the Kiev Deputy Prosecutor instituted a civil action in the Economic Court on behalf of the State Administration of Affairs against the Hotel and Alpha to invalidate the 1998 JAA, as amended.<sup>227</sup> According to Mr. Kuess, “Alpha was never formally notified of this proceeding.”<sup>228</sup> On September 22, 2008, the Kiev Economic Court suspended

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<sup>220</sup> C-197.

<sup>221</sup> Kuess Affidavit, para. 41.

<sup>222</sup> Doc. C-197.

<sup>223</sup> *Id.*

<sup>224</sup> Doc. C-208.

<sup>225</sup> *Id.*

<sup>226</sup> Doc. C-207.

<sup>227</sup> Doc. R-48.

<sup>228</sup> Kuess Affidavit, para. 41.

the case because of Alpha's filing of the Request with ICSID. The suspension remains in effect pending the outcome of this ICSID proceeding.<sup>229</sup>

#### **IV. The Tribunal's Findings of Fact**

##### **A. Factual Disputes Regarding the Alleged Agreements Through 1998 Concerning Floors 11-12 of the Hotel**

149. As noted above, the relevance of the pre-1998 agreements is not entirely clear given that the 1998 JAA superseded the earlier agreements and Claimant's claims rest entirely on the 1998 JAA and subsequent agreements. Nevertheless, Respondent appears to be alleging that the pre-1998 agreements are relevant because (1) in its view, the circumstances surrounding the agreements demonstrate that any investment by Claimant was not in accordance with the laws and regulations of Ukraine; (2) any investments made pursuant to these earlier agreements are not legitimate contributions to the 1998 contract that purported to establish a "joint activity" under the laws of Ukraine; and (3) any investments pursuant to these agreements took place outside Ukraine and thus are not covered by the UABIT. These issues will be addressed in section VI.D below, which deals with the Tribunal's jurisdiction. However, the Tribunal makes three preliminary observations on these points as they affect the need for the Tribunal to reach certain factual findings.

150. As noted, Respondent has sought to establish that Claimant's alleged investments prior to 1998 were not made in a legitimate "joint activity," and so could neither constitute a legal "contribution" for purposes of the 1998 JAA nor create certain economic rights that are attendant to participation in a joint activity. However, as Claimant's claims are based on the 1998 JAA and subsequent agreements, the relevant legal question is whether the 1998 JAA created a joint activity, not whether the *previous* agreements did so. The pre-1998 agreements are not relevant to this question, particularly given that (as shall be discussed) both sides agree that the 1998 JAA corrected any legal problems with the earlier agreements and superseded them.

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<sup>229</sup> Doc. R-48.

151. Second, Respondent points to the pre-1998 agreements as support for its position that Claimant's investments were not in accordance with the laws and regulations of Ukraine. However, as discussed in detail in the section on jurisdiction below, Respondent does not claim that the 1998 JAA and subsequent agreements were illegal, either in isolation or based on events prior to 1998. With respect to the investments made prior to 1998, Respondent does not provide a clear explanation of any alleged illegality, except to the extent discussed below, and those allegations relate (except where indicated) to the actual money flows rather than to the legality of the pre-1998 agreements themselves.

152. Third, Respondent argues that it was clear that "payments to Alpha prior to September 1998 were not considered Alpha's profits at all."<sup>230</sup> According to Respondent, subsequent attempts to treat payments to Alpha as an allocation of profits "were not and could not be successful. The agreement of the parties could not change the simple fact that the monies alleged as Alpha's investment to Ukraine have never been transferred to the Hotel, but were directly paid to Pakova."<sup>231</sup> However, Respondent's argument again pertains to the route of the actual payment transactions prior to 1998, not to the legal validity or form of the earlier agreements.

153. For the aforementioned reasons, the Tribunal need not make factual or legal findings on the validity of the pre-1998 agreements. However, given that the parties dedicated a significant portion of their arguments to the terms and validity of such agreements, the Tribunal will, for the sake of completeness, address certain issues that remain in dispute.

## **1. Alleged Backdating of Certain Agreements**

### **a. The Parties' Positions**

154. As noted, Respondent alleges that the First General Agreement, the 1994 JAA, the Second General Agreement, the 1994 Additional Agreement on Profit Distribution and the 1994 construction contracts were backdated. According to Respondent, the "First General

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<sup>230</sup> Counter-Memorial, para. 49.

<sup>231</sup> *Id.* at para. 50.



Agreement” and the 1994 JAA “were (allegedly) concluded ostensibly on the same date and by the same representatives of the Parties . . . but in [ ] different places: [the First General Agreement] in Kiev, while [the 1994 JAA] in Villach, Austria . . . . The only rational explanation can be the backdated fabrication of both agreements for the purposes of obtaining certain benefits.”<sup>232</sup> Respondent also notes that the first opinion of Mr. Rozenblit provided that the 1994 JAA “contained no indication of the place and time of its conclusion, and was ‘approved by not known whom [*sic*] on July 20, 1994.’”<sup>233</sup> According to Respondent, this fact indicates that there was another pre-existing version of the document.

155. To support its argument that the agreements were backdated, Respondent presented the expert opinion of a handwriting specialist of the Ukrainian Ministry of Justice, Ms. N. S. Zvezdina. Among other things, the opinion concluded that Mr. Nichiporenko’s signatures on the First General Agreement and the Appendix to the Second General Agreement, both of which were ostensibly signed in 1994, instead “correspond to the signatures, as executed by Nychyporenko O.V. in the documents for 1996.”<sup>234</sup>

156. Respondent also claims that a Hotel seal affixed to the 1994 JAA was not used until 1996. In support of this position, Respondent produced a separate expert opinion of “Senior Scientist” Ms. V.S. Kulykovska<sup>235</sup> from the Kyiv Scientific Research Institute of Legal Expert Examinations of the Ministry of Justice of Ukraine, who concluded that “. . . the seal imprints on behalf of hotel complex ‘Dnipro’ were affixed not at the time of which those documents are dated (not in 1994)” and cites the fact that the seal affixed to the 1994 JAA and other July 1994 agreements had only “been used to witness documents for the period since November 1996 . . . .”<sup>236</sup> Respondent also notes that a seal affixed to the original version of the 1994 JAA contains an identification code that was not used until 1996.<sup>237</sup> Respondent points out that the

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<sup>232</sup> Counter-Memorial, para. 18.

<sup>233</sup> *Id.* at para. 17.

<sup>234</sup> Doc. R-45.

<sup>235</sup> Doc. R-46.

<sup>236</sup> *Id.* at p. 2.

<sup>237</sup> Counter-Memorial, para. 14.

identification codes were not required until a modified Ukrainian Cabinet of Ministers Resolution No. 276 went into effect on January 25, 1996.<sup>238</sup>

157. In addition, the Second General Agreement – which was allegedly executed on July 24, 1994, and which records, just under its title, the words, “24 July 1994 Kiev” – indicates that the Hotel was represented by Mr. Nichiporenko. However, Respondent produced an internal Hotel memorandum confirming that Mr. Nichiporenko was in Yalta on a business trip from July 24-27, 1994.<sup>239</sup>

158. With respect to the July 24, 1994, Additional Agreement on Profit Distribution, Respondent notes that the agreement “has no date on its Russian counterpart” and argues that “[t]he date and place in the translation . . . is a pure invention.”<sup>240</sup> Respondent again notes that Mr. Nichiporenko was traveling on the date the agreement was allegedly signed, and that there is no seal affixed to the agreement.<sup>241</sup>

159. With regard to the construction contracts, Respondent concedes that “[t]hese contractor’s agreements provide less grounds for similar doubts as to the execution thereof,” though it draws attention to the fact that these agreements also contain seals from 1996.<sup>242</sup>

160. Mr. Kuess testified during the Hearing that the First General Agreement and the 1994 JAA were both signed on July 3, 1994, and that “[Mr. Nichiporenko] was sitting next to me and we signed all of the contracts together.”<sup>243</sup> Mr. Kuess also testified that the two documents were signed in the same place, but he could not remember whether it was Kiev or Villach, and suggested that the discrepancy in the written notations may have occurred “during

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<sup>238</sup> Doc. R-14.

<sup>239</sup> Doc. R-17.

<sup>240</sup> Counter-Memorial, para. 24.

<sup>241</sup> *Id.*

<sup>242</sup> Counter-Memorial, n.23.

<sup>243</sup> Kuess Testimony, Tr. 1, p. 215, lines 1-25.

translation.”<sup>244</sup> The Tribunal notes that while the word “Kiev” does appear on Appendix 1 to the 1994 JAA, it does not appear on the 1994 JAA itself.

161. As noted above, Mr. Kuess drew attention to the fact that the original bank loan documents are dated July 5, 1994 and referred to the “Guarantee Agreement” with Raiffeisenbank, an Austrian bank, that was signed by Pavel Kovalenko in August 1994 in Limassol, Cyprus, setting forth his personal guarantee of the bank’s loan to Alpha of USD 1,500,000.<sup>245</sup> Mr. Kuess argued that the loan was proof that “there must have been other contracts or agreements before” July 5.<sup>246</sup>

### **b. The Tribunal’s Findings**

162. The Tribunal has serious concerns about the authenticity of several of the agreements that Claimant has presented. Respondent has provided strong evidence that the versions of the First General Agreement and the 1994 JAA presented to the Tribunal were backdated. While Mr. Kuess testified as to his recollection of the date of signature of the documents, he could not recall the place of signature. Furthermore, Claimant has left essentially unrebutted Respondent’s expert testimony regarding the signatures and seals affixed to the documents. Apart from speculation by Mr. Kuess regarding potential translation difficulties, Claimant has also failed to explain the internal inconsistencies in the documents as to the place of signature.

163. The Tribunal is similarly concerned about the authenticity of the Second General Agreement. Claimant has failed to rebut the analysis presented in the testimony of Respondent’s handwriting expert, and has failed to explain the fact that Mr. Nichiporenko was apparently traveling in Yalta at the time the document was allegedly signed in Kiev. Similar concerns arise with respect to the Additional Agreement on Profit Distribution.

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<sup>244</sup> Kuess Testimony, Tr. 1, p. 221, lines 2-19.

<sup>245</sup> Doc. C-204 (showing a credit guarantee document dated July 5, 1994, but signature by Mr. Kovalenko dated in August 1994).

<sup>246</sup> Kuess Testimony, Tr. 1, p. 227, lines 1-22.

164. As Respondent concedes, evidence regarding the backdating of the construction agreements is less compelling.

165. On the other hand, Respondent appears to admit that there was some form of agreement in place prior to 1996 and that Claimant made payments related to the reconstruction effort pursuant to those agreements. For example, Claimant submitted a payment instruction from the Hotel to Alpha dated “22 August 1995” that states that the instruction is “[i]n accordance to General Agreement dated 24 July 1994,” *i.e.* the Second General Agreement.<sup>247</sup> This instruction indicates that, in fact, the Second General Agreement existed prior to 1996, *i.e.*, before the time when Respondent alleges the agreement was created. Furthermore, Counsel for Respondent conceded during the Hearing that Respondent does:

not assert that none of the agreements was signed on July 3rd 1994. We are just trying to demonstrate and show that one of the agreements was not signed on July 3rd 1994, and that agreement was exactly the general agreement which was ostensibly signed in Kiev. Probably the second agreement, dated July 3rd 1994, actually was signed in Villach on 3rd July 1994, maybe. This is very hard to either confirm or to disprove.<sup>248</sup>

166. Furthermore, as Mr. Kuess noted, the date of Mr. Kovalenko’s guarantee agreement evidences the existence of some arrangement among the parties in 1994.

167. To conclude this discussion, while the Tribunal finds the evidence of the alleged backdating troubling, it does not need to make any definitive findings in this regard. As explained above, the parties agree that none of the allegedly backdated documents were in effect at the time the alleged breaches of the UABIT took place and Claimant’s claims are not based upon any alleged breach of the pre-1998 agreements. The alleged backdating of the pre-1998 agreements, in itself, does not affect the Tribunal’s jurisdiction or its analysis of the merits.

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<sup>247</sup> Doc. C-125.

<sup>248</sup> Tr. 1, p. 227, lines 23-25; p. 228, lines 1-6.

## 2. Registration of Agreements and Investments

### a. The Parties' Positions

168. Claimant makes much of the fact that the various agreements and certain alleged investments were registered with the Ukrainian authorities.<sup>249</sup> Claimant concludes that “[t]he effect of these registrations is that the form, structure, and subject matter of the Agreements have been determined to correspond to Ukrainian law; the investments are determined to have been made; and no further challenge is permissible either to the form, structure, or subject matter of the registered Agreements or to the existence or amounts of the registered investments.”<sup>250</sup> In support of this position, Claimant points to the testimony of its expert witness, Ukrainian attorney Andrii Omelchenko, who concluded that registration of “foreign investments and of agreements regulating such foreign investments confirms compliance of the respective investment and agreement with Ukrainian law and precludes further challenge to such investments and agreements.”<sup>251</sup>

169. Respondent rejects this conclusion, and in essence asserts that the registration of investment agreements is merely a ministerial act confirming that the documents have been submitted in the correct form.<sup>252</sup> Respondent questions whether, in fact, all of the investments and agreements have been registered,<sup>253</sup> and also whether the registration of the allegedly backdated documents was fraudulent.<sup>254</sup> Respondent also asserts that “registration of agreements themselves *per se* does not provide protection to would-be investments,” that evidence regarding the registration of investments was incomplete and does not in any case confirm that investments were actually made, and that any registration cannot transform what was in essence a creditor/borrower relationship into a joint activity or demonstrate the existence

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<sup>249</sup> Memorial, pp. 21-22, paras. 5-7.

<sup>250</sup> *Id.* at pp. 21-22, para. 7.

<sup>251</sup> Expert Opinion of Andrii Omelchenko, para 1.6 (“Omelchenko Opinion”).

<sup>252</sup> Counter-Memorial, para 103.

<sup>253</sup> *See, e.g., id.* at paras. 47, 106-107.

<sup>254</sup> *See, e.g., id.* at paras. 47-48, 109.

of an actual investment.<sup>255</sup> Finally, Respondent argues that, while registered investments are protected by the FIL, the FIL does not provide for investor-state arbitration.<sup>256</sup>

### **b. The Tribunal's Findings**

170. In the jurisdictional section below, the Tribunal will examine the question of whether registration precludes further legal challenge to an investment or investment agreement. Furthermore, as explained in that section, there are unanswered questions at least with respect to whether Claimant properly registered its investments, as opposed to the underlying agreements. The Tribunal will examine in that section the question of whether any potential deficiencies in the registrations rendered Claimant's alleged investment illegal under the laws and regulations of Ukraine.

171. With respect to the merits of Claimant's claims, the Tribunal notes that, based on Respondent's arguments, the question of whether the agreements and investments were registered appear only to be relevant with respect to the question of whether Ukraine has violated the FIL and not to whether Ukraine violated the UABIT. The Tribunal will examine this question in the discussion of the merits.

172. Finally, as to Respondent's allegation that registration of the allegedly backdated agreements was fraudulent, there is no need for the Tribunal to make a finding on that point for the simple reason that – as explained above – the allegedly backdated documents do not form the basis of Claimant's claims.

### **3. Effect of the Parties Entering Into Certain Agreements After Works Were Allegedly Complete**

173. Respondent asserts that it was inappropriate or perhaps impermissible for the Hotel and Claimant to enter into agreements for which the underlying work had already been completed.<sup>257</sup> Respondent does not, however, contest the fact that there was an ongoing commercial

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<sup>255</sup> *Id.* at paras. 102-110.

<sup>256</sup> *Id.* at para 104.

<sup>257</sup> *See, e.g., id.* at paras. 72-74.

relationship – whether it be a loan arrangement, a joint activity or some other arrangement – between the Hotel and Claimant at the time the various agreements were negotiated. Respondent has not provided any reason why the parties to such arrangements are not entitled to modify the terms governing those arrangements, whether or not Pakova had already completed its work. To the extent Respondent has presented any objection, the Tribunal understands the argument to be pertinent only to the question of whether the various agreements established a legitimate “joint activity.” This issue will be addressed in section VI.D below.

#### **4. Shifting Parties to the Various Agreements**

174. Respondent notes in passing that the 1998 JAA between the Hotel and Claimant purported to terminate the First General Agreement, to which Pakova was a party, and the agreements between the Hotel and Pakova, to which Alpha was not a party.<sup>258</sup> The Tribunal agrees that there are questions as to the authority of the Hotel and Claimant to terminate the agreements involving Pakova. Respondent does not, however, assert any illegality in this regard, and so the Tribunal is not called upon to make any findings on this point. This is a matter to be resolved, if at all, among the Hotel, Claimant, and Pakova.

#### **B. Factual Disputes Regarding the 1997 and 1999 Agreements Concerning Floors 8-10 of the Hotel**

175. Respondent argues that the 1997 agreement between the Hotel and Pakova was inextricably linked to the 1999 JAA among the Hotel, Pakova and Alpha, and that the relationship between the two brings into question the legitimacy of the 1999 JAA. First, Respondent asserts that Pakova’s work related to floors 8-10 was essentially complete and paid for by the time of the 1999 JAA, which raises the question of why the 1999 JAA was necessary given that it was designed to help pay for precisely such work. Second, Respondent asserts that certain of the certificates allegedly proving the value of Pakova’s work on floors 8-10 were fraudulent. The Tribunal shall address each of these points in turn.

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<sup>258</sup> *Id.* at para. 51.

**1. The Timing of Completion and Payment of Works Performed by Pakova**

**a. The Parties' Positions**

176. Respondent argues that the 1997 agreement between the Hotel and Pakova related, in part, to floors 8-11 while the 1999 JAA pertained to floors 8-10.<sup>259</sup> Respondent also notes that Pakova had already been paid USD 1,074,500 in 1998,<sup>260</sup> and that a report indicates that, by May 7, 1998, the work related to floors 8-10 was substantially completed at a cost of USD \$1,026,300.<sup>261</sup> Noting the rough equivalence between the cost and the payment related to the work, Respondent concludes that Pakova's work for floors 8-10 had already been paid for separately and independently from the 1999 JAA, and delivered to the Hotel.<sup>262</sup> Given that the work was already complete and paid for, Respondent concludes, Pakova could not contribute its work on floors 8-10 to the joint activity.<sup>263</sup>

**b. The Tribunal's Findings**

177. It does, indeed, appear that Pakova's work on floors 8-10 had largely been completed by the time the 1999 JAA was executed. Such evidence includes, for example, the reports "on the transfer of works of reconstruction of 8<sup>th</sup>, 9<sup>th</sup>, 10<sup>th</sup> floors," which indicate that the work was completed by May 1998.<sup>264</sup> However, whether those works had been paid for by the time the 1999 JAA was executed is a more difficult question.

178. Respondent appears to assert that Pakova's work on floors 8-10 was valued at only approximately USD 1 million, while the remaining USD 1.7 million was related to other work. The record does not support this allegation.

179. According to Annex 1 of the Additional Agreement to Contract No. 6/97 between the Hotel and Pakova, the value of Pakova's work performed was USD 2,186,589.06, covering the

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<sup>259</sup> *Id.* at para. 63.

<sup>260</sup> *Id.* at para. 71.

<sup>261</sup> *Id.* at paras. 61- 69.

<sup>262</sup> *Id.* at paras. 71-72. Respondent points to Doc. R-21 in support of its assertion that USD 1,074,500 had been paid to Pakova in 1998. Counter-Memorial, para. 71.

<sup>263</sup> *Id.* at para. 73.

<sup>264</sup> *See* Doc. R-4; Doc. R-5.



work specified in 27 listed certificates of performance.<sup>265</sup> According to the certificates, USD 1,990,017 was associated with work on floors 8-10, and an additional USD 37,344 was associated with floors 8-11. The rest of the certificates pertained to floor 11 alone or other work such as the health center. This evidence indicates that (1) the work associated with floors 8-10 was valued at well in excess of USD 1 million; and (2) much of the work associated with floors 8-10 had not, in fact, been paid for at least by March 19, 1999.<sup>266</sup>

180. There are, however, difficulties that neither party has reconciled. The March 19, 1999, Additional Agreement indicates that the total contract price for the works covered by the agreement was USD 2,776,000 and indicates that the Hotel had paid approximately USD 1,074,500 to Pakova. However, the Annex to the Additional Agreement calculates the “[a]mount of performed works” as USD 2,186,589.06 and indicates that the Hotel had paid only USD 485,089.06. The discrepancy between the figures cited in the Additional Agreement and the Annex is USD 589,410.94. Thus, while the Additional Agreement indicates that the Hotel paid this additional amount (as part of the USD 1,074,500), it is not clear what work the payment was related to.

181. Respondent notes that the total cost of materials associated with the work on floors 8-10 was USD 558,767, which is very close to the aforementioned discrepancy.<sup>267</sup> However, as Respondent also notes, the cost of materials was already included in the values of the certificates reported in the Annex, *i.e.*, in the USD 2,186,589.06 figure.<sup>268</sup> Therefore, if the discrepancy relates to the cost of materials, and the Hotel paid this amount in addition to the USD 2,186,589.06 for the cost of Pakova’s work, then effectively the Hotel would have paid twice for the materials.

182. In any case, it is undisputed that (1) the Hotel had paid approximately USD 1 million to Pakova by the time the parties entered into the 1999 JAA; and (2) at that time, the Hotel owed

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<sup>265</sup> See Doc. R-29.

<sup>266</sup> See *id.*

<sup>267</sup> Counter-Memorial, n.91.

<sup>268</sup> See C-131, pp. 17-54 (listing certificates of work completed by Pakova, which include costs for both labor and materials); see also Counter-Memorial, n.91.

Pakova an additional USD 1.7 million approximately. The Tribunal has weighed the evidence and concludes that the vast majority of the outstanding payments related to floors 8-10.

## **2. The Allegedly Fraudulent Work Performance Certificates**

### **a. The Parties' Positions**

183. Respondent alleges that a large number of the certificates of work performed by Pakova, which evidence the USD 1.7 million owed to Pakova, were fabricated or otherwise fraudulent.<sup>269</sup> Respondent asserts that this fraud also taints the 1999 JAA. In support of this claim, Respondent makes the following arguments:

- A letter from Ms. Luganova in October 1998, lists only 18 certificates, while Attachment 1 of the Additional Agreement of March 19, 1999, lists 27 certificates. The 14 certificates that were listed in the 1999 JAA (and which totaled approximately USD 1 million) were drawn from those 27 certificates and some were not listed in the October 1998 letter.<sup>270</sup>
- Some of the certificates contained adjustments in violation of Ukrainian law or used exchange rates that were “neither logical, nor legitimate.”<sup>271</sup>
- Certain of the certificates listed in the 1999 JAA did not pertain to work on floors 8-10.<sup>272</sup>
- Certain of the certificates were not properly signed and some lack dates.<sup>273</sup>

184. Each of these issues is discussed below.

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<sup>269</sup> Counter-Memorial, paras. 76-94.

<sup>270</sup> See Doc. R-22.

<sup>271</sup> Counter-Memorial, para. 89.

<sup>272</sup> See *id.* at para. 92.

<sup>273</sup> See *id.* at para. 87.

**b. The Tribunal's Findings**

185. Respondent makes much of the fact that the letter from Ms. Lukanova to Pakova in October 1998 listed 18 certificates (numbered consecutively 1-18),<sup>274</sup> while Annex 1 of the Additional Agreement between the Hotel and Pakova, listed nine additional certificates numbered 19-27.<sup>275</sup> Respondent implies that these nine certificates were fraudulent. Eleven of the certificates listed in the 1999 JAA were drawn from the group of certificates numbered 1-18, while three were drawn from the group numbered 19-27. In Respondent's view, the inclusion of certificates from this second category demonstrates that the 1999 JAA was grounded in fraud.

186. Upon examination, it is clear that the list of certificates that is attached to the October 16, 1998, letter from Ms. Lukanova was created for a different purpose than the list attached to the 1999 JAA. In her letter, Ms. Lukanova complains of the fact that Pakova failed to perform work related to the training and recreational center, night bar, bar Express, and "conditioning system."<sup>276</sup> The list of 18 certificates attached to her letter by and large do not relate to this unfinished work (although four relate to "conditioning"). Thus, the list appears to itemize only the work that has already been completed. The nine additional certificates listed in the Annex to the Additional Agreement relate primarily to the work that had previously been identified as unfinished, namely the training center, the night bar (including "ventilation and conditioning"), and other matters such as the fire alarm. In short, while the list in the letter referred to certificates of work that had been completed, the list of certificates in the Additional Agreement referred to all works covered by the 1997 Agreement.

187. Respondent notes that the Additional Agreement indicates that the Hotel's Chief Engineer V. L. Sharubin had signed all 27 certificates. Mr. Sharubin was apparently dismissed on September 15, 1998. The Tribunal agrees with Respondent that it is peculiar that the Additional Agreement indicates that Chief Engineer Sharubin has signed the additional nine certificates, which covered work that apparently had not been completed as of October 1998. However, there is no indication of when those nine certificates were signed, or whether there was

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<sup>274</sup> See Doc. R-22.

<sup>275</sup> See Doc. R-29.

<sup>276</sup> See Doc. R-22.

a dispute about whether Mr. Sharubin signed the certificates improperly. The record is simply not sufficient to assume fraud, particularly given that GEYA confirmed the accuracy of the USD 1.7 million figure.<sup>277</sup>

188. The Tribunal makes two additional observations with respect to the alleged fraud. If the additional certificates were, indeed, fraudulent, that is a matter to be resolved between the Hotel and Pakova. Alpha was entitled to rely on the representations of the Hotel and Pakova when it entered into the 1999 JAA. Second, while not dispositive of the legal merits of the matter, the allegedly fraudulent certificates included in the 1999 JAA totaled only USD 30,547 or less than 2% of the USD 1.7 million allegedly owed to Pakova.<sup>278</sup>

189. Respondent's other allegations regarding the certificates are similarly unsubstantiated. While Respondent alleges that certain certificates of work were not in accordance with Ukrainian law, it makes this assertion without explanation or even reference to specific provisions of the law.<sup>279</sup> Furthermore, while Respondent asserts that it is "neither logical, nor legitimate" to use an exchange rate that was effective on the date of conclusion of the November 3, 1997, agreement between the Hotel and Pakova, Respondent does not explain why the methodology was not permissible or logical.<sup>280</sup>

190. Finally, while Respondent alleges that certain certificates were improperly signed or lack dates, the Tribunal concludes that such formal deficiencies do not in themselves demonstrate fraud. In any case, again, there has been no suggestion that Alpha played any part in these alleged deficiencies. Alpha was entitled to rely on the representations of the Hotel and Pakova when it entered into the 1999 JAA.

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<sup>277</sup> Trusova Affidavit, para. 12.

<sup>278</sup> See Doc. C-132, Enclosure 2 (listing certificates 12, 13, and 14 as being included as Pakova's contribution to the 1999 JAA, the value of which totals USD 30,547).

<sup>279</sup> See Counter-Memorial, para. 83 (asserting, without specifying a particular provision of Ukrainian law, that "unlike February 1998 Certificates, the Certificates under discussion bear no date, which is contrary to the Ukrainian laws and may be considered a ground for declaring them invalid"); see also *id.* at para. 88 (asserting that certain adjustments based upon a "market relations factor" were "not contemplated by the Ukrainian laws," without further elaboration).

<sup>280</sup> Counter-Memorial, para. 89.

191. For the foregoing reasons, the Tribunal finds that Respondent has not sufficiently substantiated its claim that the certificates evidencing Pakova's work were fraudulent or, even if established, how Pakova's allegedly fraudulent work certificates would undermine the legitimacy of Claimant's separate, monetary contribution under the 1999 JAA or the Tribunal's jurisdiction over the dispute.

**C. The Tribunal's Findings As to Whether the State Property Fund Ordered GEYA to Include a Lower Monthly Payment Amount in Its 2003 Appraisal**

192. The parties debated at length the question of whether GEYA was instructed to conduct its 2003 appraisal as it did. As explained above, Ms. Trusova testified and was cross-examined on the matter, and Respondent provided written testimony from Ms. Timoschik that provided her views and best recollections.

193. The Tribunal notes the inconsistency in Ms. Trusova's testimony. At times, she indicated that she was compelled to follow the directions from the State Property Fund. At other times, she asserted that she had some discretion in the matter, but could not convince the State Property Fund to follow her preferred course and that GEYA's appraisal would have been rejected if it did not follow the wishes of the State Property Fund. The Tribunal also notes, however, that Ms. Timoschik could not recall precisely what she said to Ms. Trusova but merely asserted that, whatever she may have said, Ms. Trusova was not compelled to follow the advice of the State Property Fund.

194. On the basis of the evidence before it, the Tribunal concludes that GEYA was following the instructions of the State Property Fund and that Ms. Trusova felt some pressure to do so, even if only by the practical consideration that her appraisal would otherwise have been rejected. Whether or not the appraisal followed the proper procedures and methodology, and whether or not the instructions of the State Property Fund were legally binding on GEYA, the Tribunal credits Ms. Trusova's testimony to the extent that it finds that, at a minimum, the State Property Fund was complicit in the determination that GEYA ultimately made.

#### **D. Dispute as to the Existence of a Joint Activity**

195. The parties disagree as to whether the 1998 and 1999 JAAs created a “joint activity” under Ukrainian law. Respondent argues that, while the 1998 and 1999 JAAs are not “illegal *per se*,” they are incapable of giving rise to “joint ownership of the assets of joint activity” under Ukrainian law because of the many purported irregularities that, in Respondent’s opinion, render Alpha’s claims “totally groundless.”<sup>281</sup>

196. In this section, the Tribunal shall examine the question of whether the agreements gave rise to a joint activity under Ukrainian law. Respondent also raises other issues regarding the legality of certain aspects of the agreements, which the Tribunal shall address in section VI.D.3.d below.

##### **1. The Positions of the Parties**

197. Respondent relies on Mr. Rozenblit’s conclusion that the 1994 JAA and its amendments “did not comply with the laws” of Ukraine.<sup>282</sup> On this basis, Respondent argues that there was no joint activity between Alpha and the Hotel, and that certain of the legal defects Mr. Rozenblit cites were not immediately “remedied, such as separate bookkeeping.”<sup>283</sup> Consequently, Respondent argues, the “improvements” that were carried out on the top floors of the Hotel were “not acquired or created as a result of joint activity.”<sup>284</sup>

198. Respondent also contends that the minimum monthly payments to Claimant under the 1998 and 1999 JAAs were not a permissible form of “profit distribution.”<sup>285</sup> Specifically, Respondent asserts that a requirement to make minimum monthly payments even when the Hotel experiences a loss is “incompatible” with Article 1137 of the Ukraine Civil Code.<sup>286</sup> According to Respondent’s legal expert, Professor Maydanyk, any requirement of “guaranteed payment” in

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<sup>281</sup> Counter-Memorial, para. 256.

<sup>282</sup> Respondent’s Second Post-Hearing Submission, para. 16.

<sup>283</sup> Respondent’s First Post-Hearing Submission, para. 35 (pointing out that the lack of separate bookkeeping was noted in 1998, two years after Rozenblit issued his legal opinion).

<sup>284</sup> *Id.*

<sup>285</sup> *Id.* at paras. 42-43.

<sup>286</sup> *Id.* at paras. 44, 48; *see also* Respondent’s Second Post-Hearing Submission, paras. 123-124.

the absence of profit is “void” as contrary to the “norms” of the Ukraine Civil Code.<sup>287</sup> He contended that such requirements are “against the legal nature of joint activity . . . When there is a guaranteed payment, this will in fact change the share distribution in joint activity. So I think these conditions are illegal.”<sup>288</sup>

199. In contrast, Claimant’s legal expert, Professor Omelchenko, argued that both the 1998 and 1999 JAAs were “entered into and in compliance with applicable Ukrainian law” and that they constitute “binding obligations.”<sup>289</sup> At the Hearing, Professor Omelchenko confirmed his opinion that “the joint activity agreements of 1998 and 1999 are indeed valid and are enforceable by the parties.”<sup>290</sup> Claimant also refers to Article 204 of the Civil Code as establishing a “presumption of transaction validity” that would apply in the absence of any law or court decree finding the arrangement invalid.<sup>291</sup>

200. Claimant argues the propriety of the JAAs was “legally confirmed” in legal opinions that were initiated and “organized” by the Hotel.<sup>292</sup> Claimant notes that Mr. Rozenblit’s November 18, 1996, opinion, which was issued after the conclusion of the 1996 JAA,<sup>293</sup> judges the “abovementioned agreements,” including the First General Agreement and the 1996 JAA, “lawful.”<sup>294</sup> The opinion refers to, among other things, the FIL for the proposition that the investment for the top floors was “conducted in accordance with” Ukrainian law.<sup>295</sup> Claimant emphasizes that Respondent only mentioned the earlier September 1996 opinion from Mr. Rozenblit that was rendered before the 1996 JAA corrected the problems enumerated in that prior opinion.<sup>296</sup>

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<sup>287</sup> Tr. 5, p. 165, lines 15-17; p. 166, line 4; p. 169, line 8; p. 170, lines 22-25; p. 171, lines 6-10, 23-24.

<sup>288</sup> *Id.* at p. 166, lines 3-12.

<sup>289</sup> Omelchenko Opinion, para. 6.

<sup>290</sup> Tr. 5, p. 9, lines 22-24.

<sup>291</sup> *See* Claimant’s First Post-Hearing Submission, n.7; Omelchenko Opinion, p. 7, para. 1.11. Article 204 of the Ukraine Civil Code states that a “transaction shall be legitimate, unless the law directly establishes its invalidity or the court invalidates it.” Doc. C-25.

<sup>292</sup> Reply, p. 4, para. 8.

<sup>293</sup> *See id.*

<sup>294</sup> Doc. R-16, p. 2.

<sup>295</sup> Reply, p. 4, para. 8.

<sup>296</sup> *Id.* at n.2.

201. Claimant also refers to the affidavit of Mr. Igor Bozhenko, a Ukrainian attorney retained by the Hotel from 1998-2001.<sup>297</sup> In that capacity, and prior to the conclusion of the 1998 and the 1999 JAAs, Mr. Bozhenko “conducted a review” of the existing “contractual documentation” of the Hotel, including the then existing arrangement for the renovation of the top floors, “to make sure that it complied with the Ukrainian legislation at the time.”<sup>298</sup> He “determined” that the “relationship” between the Hotel and Alpha “corresponded with the structure of a joint activity agreement provided for by the Civil Code of USSR.”<sup>299</sup> He concluded, however, that “by 1998 some of those agreements [concluded between 1994 and 1996] contradicted one another and as a whole they did not entirely comply with the legislation on foreign investment regime” that was “adopted” by Ukraine in 1996.<sup>300</sup>

202. Mr. Bozhenko states that he “took part in negotiation and drafting” of the 1998 and 1999 JAAs.<sup>301</sup> He explained that he “was asked to write a new version of agreement . . . so that it would comply with current Ukrainian legislation of the time.”<sup>302</sup> According to Mr. Bozhenko, the 1998 agreement “did not reflect a newly made agreement but rather a new version of an existing agreement” between the Hotel and Alpha.<sup>303</sup> Claimant argues that Respondent did not call Mr. Bozhenko as an expert witness at the Hearing, and so “is not entitled to regard his affidavit . . . as in any way impeached.”<sup>304</sup>

203. Claimant also emphasizes that the various arrangements were discussed extensively with the Hotel and relevant government agencies. According to Mr. Kuess, Alpha “always discussed everything with representatives of the state tourism committee, and every decision was discussed . . . and agreed with them,”<sup>305</sup> including the extension of the 1998 and 1999 JAAs to 2015.<sup>306</sup>

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<sup>297</sup> See Affidavit of Igor Bozhenko, para. 3 (“Bozhenko Affidavit”).

<sup>298</sup> *Id.* at para. 6.

<sup>299</sup> *Id.* at para. 8.

<sup>300</sup> *Id.* at para. 9.

<sup>301</sup> *Id.* at para. 4.

<sup>302</sup> *Id.* at para. 10.

<sup>303</sup> *Id.* at para. 10.

<sup>304</sup> See Claimant’s Second Post-Hearing Submission, p. 4.

<sup>305</sup> Tr. 1, p. 157, lines 13-17.

<sup>306</sup> *Id.* at p. 149, lines 10-21.



Claimant notes that the “specific form of the agreements was determined by SE Dnipro Hotel management and by Ukrainian State officials,”<sup>307</sup> a contention that Respondent did not deny.

204. In addition, Mr. Tsybuch, who served as the “Head” of the State Tourist Administration throughout the relevant period, wrote that the “joint activity” was “always properly approved by the competent authorities and all the necessary permissions were always duly issued, because Hotel Dnipro was a state enterprise and was of a vital importance for the state of Ukraine and for its capital Kiev. . . . The foreign investments contributed by the Austrian investor [Alpha] into Ukraine were duly registered in accordance with the current Ukrainian laws, all the tax and budget liabilities were duly fulfilled.”<sup>308</sup> The Tribunal offered Respondent numerous opportunities to respond to Mr. Tsybuch’s letter and even suggested that Respondent might wish to consider producing Mr. Tsybuch’s alleged separate letter to the Ukrainian Government. Respondent informed the Tribunal at the end of the Hearing that it did not require such procedural measures,<sup>309</sup> and in a post-Hearing submission focused on impeaching the credibility of the representations made in the Tsybuch Letter, but did not directly contest its substance.<sup>310</sup> In any event, the Tribunal notes the statements in the Tsybuch Letter solely as supplementary, not dispositive, evidence weighing in favor of Claimant’s arguments.

## 2. The Tribunal’s Findings

205. Before examining whether the 1998 and 1999 JAAs created a joint activity under Ukrainian law, it is first necessary to determine the characteristics of such a “joint activity.” On this point, there appears to be substantial overlap in the parties’ views. According to Mr. Omelchenko, “[j]oint ownership results in the owners having an undivided interest in assets.”<sup>311</sup> During the life of the joint activity, the parties receive a share of the profits proportional to their respective contributions, unless otherwise agreed by contract.<sup>312</sup> Furthermore, “[a]t the end of the joint activities, the participants in it will receive their contributions back. And after having paid all the debts to the state budget[,] to the creditors, this common property which remains is

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<sup>307</sup> Reply, p. 4.

<sup>308</sup> Letter from V. Tsybuch to Dr. Specht, March 16, 2009, p. 1 (“Tsybuch Letter”).

<sup>309</sup> Tr. 5, p. 179, lines 6-10.

<sup>310</sup> Respondent’s First Post-Hearing Submission, pp. 61-62, paras. 153-155.

<sup>311</sup> Omelchenko Opinion, p. 9, para. 2.5.

<sup>312</sup> Tr. 4, p. 145, lines 18-24.

divided between the participants *pro rata* to their contributions, unless they otherwise agree.”<sup>313</sup> Respondent’s legal expert, Mr. Maydanyk, appeared to agree with this general description of a joint activity, at least with respect to the division of profits and, upon termination of the joint activity, the division of joint property.<sup>314</sup>

206. Turning then to the question of whether the agreements at issue in this dispute established a joint activity, the Tribunal recalls that Claimant’s claims relate only to the 1998 JAA and subsequent agreements. The Tribunal will, therefore, focus its analysis on those agreements. While Respondent complains that the pre-1998 agreements did not create a legitimate joint activity, Respondent’s own legal expert, Mr. Maydanyk, testified during the hearing that “[t]he agreements of 1998 and 1999 corrected the deficiencies in the previous agreements – I will repeat, the agreements of 1998 and 1999 corrected the deficiencies of the previous agreements, but these two agreements have their own deficiencies.”<sup>315</sup> Such remaining “deficiencies” appear to relate to the monthly profit distributions in the 1998 and subsequent agreements, which will be discussed below.

207. In addressing the question of whether the 1998 and 1999 JAAs established legitimate “joint activities,” the Tribunal will turn first to the text of the agreements, second to the pertinent provisions of the Ukraine Civil Code, and third to the content of the expert opinions and testimony.

208. Both the 1998 and 1999 JAAs express a clear intention to create a “joint activity” between the parties. The 1998 JAA is formally titled an “Agreement on Joint Investment Activities.”<sup>316</sup> Article 1.1 of the agreement states that the “Parties hereunder undertake to conduct joint activities” with respect to the 11th and 12th floors; Article 1.2 refers to the parties’ intention to earn “profit from joint activities”; Article 2.3 refers to the parties’ “contributions . . . into the joint activities”; Article 3 is titled “Joint Activities of the Parties” etc. In addition, the

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<sup>313</sup> *Id.* at p. 147, lines 7-12.

<sup>314</sup> Tr. 5, p. 171, lines 3-6 (referring to division of profits *pro rata* to the parties’ “shares”); pp. 174-175 (discussing distribution of joint property upon termination of the joint activity).

<sup>315</sup> Testimony of Roman Maydanyk, Tr. 5, p. 140, lines 21-25, (“Maydanyk Testimony”).

<sup>316</sup> Doc. C-127.

1998 JAA shows the substantive hallmarks of a joint activity. It refers to the parties' respective "contributions" (Article 2), specifies the allocation of profits (Article 5), and states that the funds and property of the joint activity shall, upon its termination, be allocated "proportionally to [the parties'] investment after reimbursement of all debt resulting from joint activities under the established procedure (Article 6)."

209. The 1999 JAA similarly expresses an intention to create a joint activity. It is formally titled "Contract on joint investment activities under the participation of a foreign investor."<sup>317</sup> Article 1.1 states that the parties "undertake by means of unification of their cash assets, property, interests and efforts to carry out the joint investment activities" with respect to floors 8-10 of the Hotel; Article 2 refers to the "contributions" of the parties to the "joint activities," Article 3 refers to the "running of the joint business" etc. In addition, Article 5 refers to the distribution of profits, while Article 6.6 indicates that "the assets and property are to be distributed between the PARTIES pro rate [*sic*] to their contributions into joint activities. . . ."

210. Respondent argues that, despite the fact that the contracts appear to establish a joint activity, the guaranteed minimum monthly payments to Alpha do not reflect a true division of profits. As explained above, the 1998 JAA required a 50/50 division of profits between the Hotel and Alpha based on certain projected occupancy rates, but required a minimum monthly payment to Alpha of USD 35,000. In 2000, in exchange for agreeing to the temporary suspension of payments, Alpha's minimum monthly payment was increased to USD 50,000. The 1999 JAA initially required an equal three-way division of profits among the Hotel, Alpha and Pakova, which, after Pakova's withdrawal from the agreement, was changed to a 50/50 division of profits between the Hotel and Alpha. However, before and after Pakova's withdrawal, Alpha was entitled to a USD 50,000 minimum monthly payment.

211. Respondent argues that the minimum monthly payment provisions are inconsistent with Articles 1137 and 1139 of the Ukraine Civil Code, which state as follows:

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<sup>317</sup> Doc. C-132.

### **Article 1137. Joint Expenses and Losses of Participants:**

1. Procedure for reimbursement of expenses and losses connected with the participants' joint activity shall be determined by the agreement between them. In case there is no such arrangement, each participant shall incur costs and losses in proportion to the value of its contribution into the joint property.

Provision under which a participant is fully exempt from participation in reimbursement for joint expenses and losses shall be invalid.

### **Article 1139. Profit Distribution:**

1. Profit received by the participants to a simple partnership agreement as a result of their joint activity shall be distributed in proportion to the value of the participants' contributions into the joint property, unless otherwise is determined by a simple partnership agreement or by the other arrangement between the participants.

Provision on depriving or refusal of the participant of the right for a part of the profit shall be invalid.<sup>318</sup>

212. Respondent did not submit its own English translation of these two Articles and did not contest Claimant's translation. Neither the parties nor their experts referred to any ruling by a Ukrainian court, or to any legislative history, on the intended meaning of these two provisions.

213. Both parties assert that the parties to a joint activity are permitted to agree to a division of profits that does not reflect their relative contributions.<sup>319</sup> The critical question, however, is whether a minimum payment is permissible, particularly if the joint activity experiences a loss. Claimant's expert, Professor Omelchenko, argued that, "[i]f the agreement stipulates that one of the parties is entitled to a fixed amount of profits, and this cannot be paid out of the results of the joint activities, it is necessary to change the terms and conditions of the agreement,"<sup>320</sup> however, "[u]ntil such time when these things are contractually changed, the terms and conditions remain the same as they were stated before."<sup>321</sup> Professor Omelchenko in effect concluded, that, in the

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<sup>318</sup> Doc. C-25.

<sup>319</sup> See, e.g., Omelchenko Testimony, Tr. 4, p. 191, lines 11-15 ("According to Article 1139 of the Civil Code, the profit is distributed among the partners in *pro rata* of their contributions, unless otherwise stipulated in the contract or agreement, or in another agreement between the parties"); Maydanyk Testimony, Tr. 5, p. 172, lines 10-25 and p. 173, lines 1-9 (arguing that fixed payments are impermissible but stating that the law permits the parties to agree "that the profits will not be distributed in *pro rata* but according to some other principle").

<sup>320</sup> Tr. 4, p. 192, lines 14-18.

<sup>321</sup> *Id.* at p. 193, lines 12-14.

absence of any mutually agreed amendment to the JAA, Alpha remains entitled to its minimum monthly payment.<sup>322</sup>

214. In contrast, Respondent's expert, Professor Maydanyk, argued that Article 1139 supported the view that if "a party is deprived of a part of its profits, this is null."<sup>323</sup> He argued that the very fixing of a set payment, "practically speaking," means that the parties are "no longer talking of profits" and that this "violation" of the Civil Code is "why such terms are considered as nil . . . ."<sup>324</sup> Respondent rejects the proposition that the proper course for the Hotel in such a situation is to seek "to amend the JAAs" in order to accommodate any period of loss rather than stopping the monthly payments.<sup>325</sup>

215. The Tribunal notes that Mr. Bozhenko, the Ukrainian lawyer who negotiated and concluded the 1998 and 1999 JAAs on behalf of the Hotel, appeared to conclude that the minimum monthly payment provisions were permissible. The Tribunal also notes that Mr. Bozhenko's opinion was not drafted in the context of litigation but to give objective advice to his client, the Hotel,<sup>326</sup> whose interests Respondent alleges were adversely affected.

216. Mr. Bozhenko's affidavit does not indicate that there was any question about the legality of the payment provisions in the 1998 and 1999 JAAs. He specifically testified in his affidavit that "a legal decision was taken to formalize the relationship between SE Dnipro Hotel, Pakova Investment Ltd. and Alpha within the agreement on joint activity" with the following elements: "- settlement of payment for works completed by Pakova Investment Ltd; - obtaining of profit by SE Dnipro Hotel and Alpha from joint operation of newly created value (reconstructed and developed floors); - securing income of Alpha through joint ownership of the newly created value - real estate property without privatization of State property."<sup>327</sup> All of these elements were embodied in the agreements he drafted. Respondent chose not to call Mr. Bozhenko as a witness at the Hearing so that his views could be subjected to cross-examination.

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<sup>322</sup> *Id.* at p. 194, lines 20-22.

<sup>323</sup> Tr. 5, p. 168, lines 10-12.

<sup>324</sup> *Id.* at p. 171, lines 6-10, 13-25.

<sup>325</sup> Respondent's Second Post-Hearing Submission, paras. 123-24.

<sup>326</sup> Bozhenko Affidavit, para. 3.

<sup>327</sup> *Id.* at para. 13.

217. The Tribunal is of the view that whether or not the 1998 and 1999 JAAs give rise to a legitimate joint activity has no bearing on the Tribunal’s jurisdiction. The agreements at issue can give rise to contractual rights, including claims to money and/or performance, regardless of whether they give rise to a joint activity. Such rights may constitute an “investment” for purposes of establishing the Tribunal’s jurisdiction. However, whether the JAAs give rise to a joint activity is central to the merits of Claimant’s claims and the damages to which Claimant asserts it is entitled. The Tribunal shall address this question in the merits section of the award. The Tribunal, however, makes two preliminary observations.

218. First, the contracts themselves contain provisions which replicate certain of the conditions of a joint activity, *i.e.*, they contain provisions on the division of profits and assets of the project which are not directly linked to any background provisions of the Ukraine Civil Code. Neither party has addressed the enforceability of these provisions as free-standing contractual obligations in the event the Tribunal concludes that the parties have not created a joint activity. However, the Tribunal recalls that Respondent has argued that the 1998 and 1999 JAAs are not “illegal *per se*,” only that they are incapable of giving rise to “joint ownership of the assets of joint activity.”<sup>328</sup> Respondent has further argued that, at least under the 1963 USSR Civil Code, even if a contract that purports to create a joint activity does not in fact do so, it may still give rise to binding contractual obligations.<sup>329</sup> It is possible, therefore, that the contractual provisions are enforceable even if no joint activity exists.

219. Second, while the parties have argued extensively about the legitimacy of the provisions requiring the minimum monthly payments, they have not addressed whether such provisions are severable from the remaining provisions of the contracts, *i.e.*, whether a finding that minimum payment provisions are impermissible would void the contracts as a whole or whether the remaining provisions would continue in force. Without prejudice to the question of whether the minimum payment provisions are permissible, the Tribunal concludes that they are severable, and that the remaining provisions of the contract – including the 50/50 division of profits in

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<sup>328</sup> Counter-Memorial, para. 256.

<sup>329</sup> *Id.* at para. 214 (“Under Article 58 of the 1963 (old) Civil Code of Ukraine, if the parties conclude a pretended agreement, *i.e.* an agreement, which was designed to conceal another type of agreement . . . the relations between them shall be regulated by the rules concerning their really intended agreement.”)

accordance with the parties' contributions – would be fully enforceable (barring any other legal infirmity with the agreements as a whole) even if the monthly payment provisions were void. The Tribunal notes in this regard that the relevant provisions in Articles 1137 and 1139 of the Ukraine Civil Code on which Respondent relies refer to the invalidity of specified “provisions” regarding profit allocation and not to the invalidity of the contracts as a whole.

## **V. Common Issues – Rules of Interpretation, Governing Law and Burden of Proof**

220. Before proceeding to a consideration of the Tribunal's jurisdiction over this dispute, the Tribunal shall address three preliminary issues: (1) the applicable rules of interpretation; (2) the governing law; and (3) the applicable principles with respect to burden of proof.

### **A. Applicable Rules of Interpretation**

221. The ICSID Convention, the ICSID Arbitration Rules, and the UABIT are silent on the rules for interpreting treaty provisions, and the parties provided little guidance in this regard. However, both Austria and Ukraine are parties to the Vienna Convention on the Law of Treaties (May 23, 1969, 1155 U.N.T.S. 331) (“Vienna Convention”),<sup>330</sup> which sets forth general rules of interpretation applicable to “treaties between States.” The Tribunal will accordingly adhere to the interpretive framework set forth in Articles 31 and 32 of the Vienna Convention, which state, in pertinent part, as follows:

#### **ARTICLE 31**

##### **General Rules of Interpretation**

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. . . .

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<sup>330</sup> Austria acceded to the 1969 Vienna Convention on April 30, 1979. Ukraine acceded on May 14, 1986. See United Nations Treaty Collection Website, Status of the Vienna Convention on the Law of Treaties, *available at* [http://treaties.un.org/Pages/ViewDetailsIII.aspx?&src=TREATY&mtdsg\\_no=XXIII~1&chapter=23&Temp=mtdsg3&lang=en](http://treaties.un.org/Pages/ViewDetailsIII.aspx?&src=TREATY&mtdsg_no=XXIII~1&chapter=23&Temp=mtdsg3&lang=en).

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**

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.

222. The Tribunal's approach is consistent with that of previous ICSID tribunals.<sup>331</sup>

223. In addition, the Tribunal will employ generally accepted rules of interpretation, such as the ones neatly summarized by the *AAPL* tribunal: (i) the tribunal should not interpret that which has no need of interpretation; (ii) effect should be given to every provision of an agreement; and (iii) a provision must be interpreted so as to give it meaning rather than so as to deprive it of meaning.<sup>332</sup>

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<sup>331</sup> See, e.g., *Phoenix Action Ltd. v. Czech Republic*, ICSID Case No. ARB/06/5, Award, April 15, 2009, para. 75 (“*Phoenix*, Award”).

<sup>332</sup> See *Asian Agricultural Products Ltd. (AAPL) v. Republic of Sri Lanka*, ICSID Case. No. ARB/87/3, Award, June 27, 1990, para. 40 (“*AAPL*, Award”).



224. Neither party during the course of this proceeding cited any relevant provision of Ukrainian law that might affect the question of interpretation of treaty provisions, domestic law, or instruments governed by domestic law.

## **B. The Governing Law**

### **1. The Law Applicable to the Tribunal's Determinations on Jurisdiction**

225. Claimant has made claims under both the UABIT and the FIL. However, as Claimant submitted this dispute under Article 9 of the UABIT, which provides for ICSID arbitration, the terms of the UABIT and the ICSID Convention are controlling for purposes of establishing the Tribunal's jurisdiction for both sets of claims. The Tribunal will determine whether it has jurisdiction under both the ICSID Convention and the UABIT.

226. The FIL is not applicable to the Tribunal's jurisdiction. Article 42(1) of the ICSID Convention calls for the application of rules agreed by the parties or, in the absence of agreement, the law of the Contracting State party to the dispute and applicable rules of international law. However, Article 42(1) is applicable only to the merits of a dispute and not to jurisdiction. As Professor Schreuer states in his Commentary, "Art. 42 addresses only the substantive law to be applied" and "does not govern questions of the tribunal's jurisdiction under Art. 25."<sup>333</sup> Indeed, as the *CSOB v. Slovakia* tribunal concluded, the question of "whether the parties have effectively expressed their consent to ICSID jurisdiction is not to be answered by reference to national law. It is governed by international law as set out in Article 25(1) of the ICSID Convention."<sup>334</sup> Article 25(1) of the Convention is discussed at length below.

227. Even if the FIL were applicable to jurisdiction, however, the Tribunal's conclusion with respect to the law applicable to jurisdiction would be consistent with the FIL. Article 26 of the FIL, entitled "Procedure for Dispute Settlements," states that "[d]isputes between foreign

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<sup>333</sup> Christoph H. Schreuer, *THE ICSID CONVENTION: A COMMENTARY* 550-551 (2d ed., 2009) ("Schreuer, ICSID CONVENTION").

<sup>334</sup> *Ceskoslovenska Obchodni Banka, A.S. v. Slovakia*, ICSID Case No. ARB/97/4, Decision on Jurisdiction, May 24, 1999, para. 35 ("*CSOB*, Jurisdiction").

investors and the state on the issues of the state regulations of foreign investments and activity of entities with foreign investments should be considered in the courts of Ukraine unless other procedure is stipulated by the international agreements of Ukraine.”<sup>335</sup> Such an “other procedure” is set forth in Article 9 of the UABIT, pursuant to which Claimant selected ICSID arbitration.

## 2. The Law Applicable to the Merits

228. With respect to the merits of the dispute, Article 42(1) of the ICSID Convention states that “[t]he Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable.” In determining the “rules of law . . . agreed” between Austria and Ukraine, the Tribunal must first look to the UABIT; however, neither Article 9 nor any other provision of the UABIT contains any express guidance on the governing law. In the absence of any such guidance, the parties have taken different positions on the applicable law.

229. Claimant argues that the UABIT and the ICSID Convention are applicable, but also contends that Ukrainian law is applicable to the extent that it is not inconsistent with the UABIT, the ICSID Convention, or the rules of customary international law.<sup>336</sup> Claimant also argues, however, that the FIL standards with respect to national treatment and expropriation are “parallel” or similar to those in Articles 3 and 4 of the UABIT, respectively.<sup>337</sup>

230. Respondent notes that there is “no immediate investment agreement (contract) between Claimant (Alpha) and Respondent (Ukraine as a State).”<sup>338</sup> Respondent argues that “it is legally logical that the UABIT shall be the primary, principal and controlling source of (rules of) law for deciding the case on the merits”<sup>339</sup> and that Claimant “agreed through its acceptance of the

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<sup>335</sup> C-13, Art. 26.

<sup>336</sup> Reply, p. 14.

<sup>337</sup> Reply, p. 20 and Claimant’s First Post-Hearing Submission, p. 9.

<sup>338</sup> Counter-Memorial, para. 151.

<sup>339</sup> *Id.* at para. 154; *see also* Rejoinder, para. 50 (reiterating Respondent’s position that the UABIT should be the principal source of law on the merits).

arbitration offer” that the UABIT was controlling.<sup>340</sup> Respondent adds that the UABIT may be “supplemented where appropriate by other relevant rules of international law.”<sup>341</sup>

231. With respect to the applicability of the FIL, Respondent argues that “the UABIT is a part of the national legislation of Ukraine. As such, the UABIT, in relation to the FIL, is simultaneously *lex posteriori* and *lex specialis* with respect to the alleged foreign (Austrian) investments . . . .”<sup>342</sup> Respondent recognizes that, under Article 8 of the UABIT, domestic law shall prevail over the BIT to the extent it provides more favorable treatment to an investment than the UABIT. However, Respondent takes the position that “Claimant has not definitely demonstrated and proved, why, and in what [fashion], the provisions of FIL . . . are more favourable than . . . [the] correlating provisions of the UABIT, and whether in the FIL itself there are sufficient grounds for application of its provisions instead of those of the UABIT. This obviously precludes the FIL from substantive application in the present case.”<sup>343</sup>

232. Respondent does not deny any role at all for domestic Ukrainian law. Respondent states that it “does not avoid referring to Ukrainian law, where appropriate. However, the use thereof, including the FIL, shall be limited for the purpose of elucidation of the facts of the case (and not the decision on the merits), which approach finds support in the international law and jurisprudence.”<sup>344</sup> Respondent argues that in proceedings such as these, questions of national law are treated as facts.<sup>345</sup>

233. The Tribunal finds that the question of whether the UABIT has been breached can only be answered by reference to the UABIT’s own terms. The Tribunal will apply the provisions of the UABIT and interpret the UABIT in a manner consistent with customary international law. In addition, where Ukrainian law defines the parties’ rights and obligations under the various contracts, such questions will be decided as questions of fact.

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<sup>340</sup> Counter-Memorial, para. 154.

<sup>341</sup> *Id.* at para. 163; Rejoinder, para. 50.

<sup>342</sup> Counter-Memorial, para. 161.

<sup>343</sup> *Id.* at para. 159.

<sup>344</sup> *Id.* at para. 162.

<sup>345</sup> *Id.* at n.175.

234. Claimant has also asserted that Respondent has breached the FIL. The Tribunal must and will apply Ukrainian law in assessing the merits of such claims.

### C. Burden of Proof

235. The ICSID Convention, the ICSID Arbitration Rules and the UABIT do not provide guidance for determining which party bears the burden of proof. In addition, neither Party referred to any provision of Ukrainian law that might bear on this subject.

236. The Tribunal agrees with the standard articulated by the *AAPL* tribunal that, with regard to “proof of individual allegations advanced by the parties in the course of proceedings, the burden of proof rests upon the party alleging the fact.”<sup>346</sup> The Tribunal notes that other ICSID tribunals have reaffirmed this principle, including one also involving Ukraine as Respondent. The tribunal in *Tokios v. Ukraine* held that the “principle of *onus probandi actori incumbit* . . . is widely recognized in practice before international tribunals.”<sup>347</sup> Further, once a party adduces sufficient evidence in support of an assertion, the burden “shifts” to the other party to bring forward evidence to rebut it.<sup>348</sup>

237. In the case before this Tribunal, both parties are in accord with these principles. For example, Claimant in its Second Post-Hearing Submission stated: “To be sure, Alpha bears the burden of proving the fact of its financial contribution. But Alpha easily met that burden. The burden to disprove that evidence then switched to Respondent.”<sup>349</sup> For its part, Respondent stated in its Counter-Memorial: “The rule that the burden of proof rests upon the claiming party is generally accepted and reflected in the principle *onus probandi actori incumbit*,” with the result that “the burden of proof rests upon the party alleging the fact.”<sup>350</sup> Respondent continued in its first Post-Hearing Submission: “About primary and auxiliary burden of proof, and when

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<sup>346</sup> *AAPL*, Award at para. 56 (citing Bin Cheng, *GENERAL PRINCIPLES OF LAW AS APPLIED BY INTERNATIONAL COURTS AND TRIBUNALS* 327 (1987)).

<sup>347</sup> *Tokios Tokelés v. Ukraine*, ICSID Case No. ARB/02/18, Award, July 26, 2007, para. 121 (“*Tokios*, Award”).

<sup>348</sup> *AAPL*, Award at para. 56, *citations omitted*.

<sup>349</sup> Claimant’s Second Post-Hearing Submission, p. 4 (citing *AAPL*, Award at para. 56); *see also id.* at p. 23 (“Once Alpha had established the fact of State affiliation of various individuals and agencies and the existence of expropriatory actions by such State actors, the burden then switched to Respondent to come forward with evidence that the State actors were acting solely in their private individual capacity”).

<sup>350</sup> Counter-Memorial, paras. 165, 167 (*citations omitted*).

the onus transfers to the other party, Respondent takes the well established general position that a party which makes an assertion or claim has the burden of proving such assertion or claim.”<sup>351</sup>

238. An additional question is the standard of proof – more specifically, what level of evidentiary showing would be sufficient to prove an assertion and would result in shifting the burden of proof to the other party. The parties have not addressed this question directly.<sup>352</sup> It is generally understood that “the probative force of the evidence presented is for the Tribunal to determine,” there being no “strict judicial rules of evidence” binding upon international arbitral tribunals.<sup>353</sup> This general principle is confirmed by Rule 34(1) of ICSID’s Arbitration Rules, which provides: “The Tribunal shall be the judge of the admissibility of any evidence adduced and of its probative value.” The Tribunal shall proceed accordingly.

## **VI. Jurisdiction**

239. According to Article 41(2) of the ICSID Convention, “Any objection by a party to the dispute that that dispute is not within the jurisdiction of the Centre, or for other reasons is not within the competence of the Tribunal, shall be considered by the Tribunal . . . .” Respondent has raised several objections that Claimant’s claims are not within the Tribunal’s jurisdiction or are otherwise inadmissible. The Tribunal will address these objections below.

240. Rule 41(3) of the ICSID Arbitration Rules states that a tribunal “may deal with” a jurisdictional or admissibility objection “as a preliminary question or join it to the merits of the dispute.” Neither Claimant nor Respondent requested a separate phase to address Respondent’s preliminary objections. Consequently, the Tribunal heard the parties on Respondent’s preliminary objections and on the merits of Claimant’s claims in a single proceeding.

241. The scope of the Tribunal’s jurisdiction is defined by Article 9 of the UABIT and Article 25 of the ICSID Convention. As previously noted, the provisions of both treaties must be

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<sup>351</sup> Respondent’s First Post-Hearing Submission, para. 96 (emphasis omitted).

<sup>352</sup> Respondent refers to this issue in passing in its Counter-Memorial at para. 127 and Rejoinder at para. 3 & n.43. Claimant does not appear to address it at all.

<sup>353</sup> *AAPL*, Award at para. 56 (citations omitted).

satisfied in order to establish the Tribunal’s jurisdiction. Article 25(1) of the ICSID Convention circumscribes the Tribunal’s jurisdiction as follows:

(1) The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State . . . and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre. When the parties have given their consent, no party may withdraw its consent unilaterally.

242. In order for the Tribunal to establish jurisdiction under the terms of Article 9 of the UABIT, the Tribunal must determine whether there is a “dispute between a Contracting Party and an investor of the other Contracting Party in relation to an investment . . . .” The Tribunal shall address each of the jurisdictional elements required under the ICSID Convention and the UABIT below.

243. As noted, Claimant has made claims under both the UABIT and the FIL. The jurisdictional issues are the same with respect to both types of claims. Article 9 of the UABIT pertains to “any dispute” between a Contracting Party and an investor with respect to an investment, without limiting such disputes to those based on claims of breach of the UABIT. Therefore, the Tribunal finds that the UABIT would permit a tribunal to assume jurisdiction over claims under the FIL provided that the remaining jurisdictional requirements under the UABIT (and, here, the ICSID Convention) are met.

#### **A. Whether the Parties Have Consented to Arbitration**

244. Article 9(1) of the UABIT calls, “as far as possible,” for the settlement of any “dispute” between a Contracting Party and an investor “through negotiations.” Article 9(2) then provides that if the dispute “cannot be settled within three months of the receipt of written notification of a sufficiently detailed claim,” then either Party is free to institute one of the dispute resolution “procedures” set forth in Article 9(2). Claimant contends that these requirements have been met, and Respondent does not contest the point.<sup>354</sup> Furthermore, under 9(2)(a) of the UABIT, “each

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<sup>354</sup> Request, paras. 30-34 and Annexes 5-10.

Contracting Party, in accordance with [the UABIT], irrevocably consents in advance . . . to submit any such disputes to the Center [*sic*] and to accept the award as binding.”

245. The Tribunal concludes that the parties to the dispute have provided the requisite consent to this arbitration.

**B. Whether There Is a Dispute Under the Terms of the UABIT and the ICSID Convention**

246. Under Article 25(1) of the ICSID Convention, Claimant must demonstrate that it is an investor of Austria that has a “legal dispute” with Ukraine. Under Article 9 of the UABIT, Claimant must demonstrate the existence of a “dispute” with Ukraine. The broad term “dispute” encompasses the narrower term “legal dispute.” Therefore, if the Tribunal finds that there is a “legal dispute” under Article 25(1) of the ICSID Convention, it perforce must find the existence of a “dispute” under Article 9 of the UABIT.

247. Claimant has asserted that it has an investment in Ukraine in the form of contributions made in connection with the 1998 and 1999 JAAs and related agreements, which gave rise to certain legal rights and interests. It also asserts that the Government of Ukraine has – either directly or through acts attributed to it – expropriated Claimant’s alleged investment in violation of Article 4 of the UABIT and taken acts with respect to that investment that amount to a denial of fair and equitable treatment in violation of Article 2 of the UABIT. Claimant has also asserted that Respondent has denied Claimant and its investments national treatment in violation of Article 3 of the UABIT and breached its contractual obligations in violation of Article 8 of the UABIT. Respondent principally asserts that, whatever actions the Hotel may have taken with respect to the 1998 and 1999 JAAs, Ukraine is not responsible directly or through attribution, and, therefore, has not violated the UABIT.

248. Claimant has also asserted that Ukraine has violated various provisions of the FIL. Respondent has denied that Claimant’s alleged investments are protected by the FIL or that the FIL is even applicable.

249. On this basis, the Tribunal concludes that there is a “legal dispute” for purposes of Article 25(1) of the ICSID Convention and a “dispute” for purposes of Article 9 the UABIT.

**C. Whether There Is a Sufficient Connection Between the Dispute and the Investment**

250. Article 25(1) of the ICSID Convention requires that the dispute “aris[e] directly out of an investment.” Article 9 of the UABIT does not require as close a relationship between the dispute and an investment, and instead requires the existence of a dispute “in relation to an investment.” In the Tribunal’s view, if a dispute is “arising directly out of an investment,” it is necessarily “in relation to an investment.” The Tribunal shall, therefore, focus its analysis on whether the dispute arises directly out of Claimant’s alleged investment. If it does, then the broader terms in the UABIT would also be met.

251. Respondent argues that “in order to properly meet ‘arising-directly-out-of-an-investment’ requirement, the legal claims ultimately must arise not out of the alleged, but from proved real investments.”<sup>355</sup> Thus, for Respondent, the question is not whether the dispute arises directly out of an investment but whether there is an investment in the first place.

252. As explained below, Claimant asserts that its investments were within the framework of the 1998 JAA, the 1999 JAA, and related contracts that established a “joint activity” with the Hotel. The basis of Claimant’s claims is that actions taken by the Hotel and other actors effectively abrogated Claimant’s rights under those contracts, and that Ukraine is responsible for those actions either directly or through attribution, and that such actions violate the terms of the UABIT.

253. The Tribunal concludes that, if Claimant’s contributions and rights arising out of the various contracts in fact qualify as “investments” under the ICSID Convention and the UABIT (as discussed in the next section), then the dispute “aris[es] directly out of” such investments,

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<sup>355</sup> Counter-Memorial, n.152.



and this particular jurisdictional requirement of Article 25(1) of the ICSID Convention – and the analogous provision of the UABIT – would be met.

**D. Whether Claimant Has Made an “Investment”**

254. In order for the Tribunal to have jurisdiction over this dispute, Claimant must establish that it has made an investment that is protected by the UABIT and that is within the ambit of the ICSID Convention. If Claimant’s interests fall within the scope of the term “investment” as used in only one of those agreements but not the other, then this Tribunal will lack jurisdiction.

255. Article 1(1) of the UABIT defines the term “investment” and states in relevant part:

The term “investment” means every kind of asset invested in connection with the economic activity of investors of one Contracting Party in the territory of the other Contracting Party in accordance with the laws and regulations of the latter Contracting Party and, in particular but not exclusively:

(a) Movable and immovable property as well as any other right *in rem*, such as mortgages, liens, pledges, usufructs and similar rights;

...

(c) Claims to money which has been given in order to create an economic value, or claims to any performance having an economic value;

(d) Intellectual and industrial property rights, in particular but not exclusively: copyrights, trade marks, patents for inventions, industrial designs and models, technical processes, know-how, trade secrets, trade names and goodwill

....

256. The use of the words “in particular but not exclusively” in the introductory clause before the recitation of the specified categories indicates that the list of investments appearing in the subparagraphs is merely illustrative of the types of “assets” that qualify as investments.

## 1. Overall Positions of the Parties with Respect to the Existence of an “Investment”

257. Claimant asserts that its “investment” is its interest in the alleged “joint activity” with the Hotel that resulted from its monetary and other contributions. While Claimant is not clear on this point, it appears to argue that this interest was created through the 1998 JAA, the 1999 JAA, the Additional Agreement No. 1 to the 1998 JAA, the Additional Agreement No. 3/03 to the 1998 JAA, and the 2003 “reinvestment.”

258. While Claimant also alleges that the pre-1998 contracts were intended to create a joint activity, none of those contracts was in effect at the time that the acts allegedly taken in violation of the UABIT took place. As the investments are comprised of Claimant’s rights under the joint activities, the pre-1998 contracts, which do not give rise to any rights because they were no longer in force at the time of the alleged violation, cannot constitute the relevant “investment” for purposes of this dispute. The investments are, instead, the package of rights created pursuant to the 1998 and subsequent agreements.

259. In its Request for Arbitration, Claimant asserted that its investment was “made in the framework of the joint investment activity” with the Hotel<sup>356</sup> and consisted of “furniture, various equipment and accessories, and substantial financial resources (cash),” in addition to its agreement to “reinvest revenues for the joint investment activity.”<sup>357</sup> Claimant did not present any argument in its Memorial that it had made an investment as defined in the UABIT or the ICSID Convention. Instead, Claimant focused on whether it had made an investment protected by the FIL. Over the course of the proceeding, however, Claimant clarified that, for purposes of the UABIT, its claimed investment consisted of (1) “currency contributions to or on behalf of a joint activity;” (2) equipment purchases made “for the benefit of the joint activity;” and (3) “collaborative efforts including design, training, sharing of know-how as to, and provision of funding for the development and operation of a four-star hotel in accordance with international standards.”<sup>358</sup> According to Claimant, those investments fall within the scope of subparagraphs (a), (c), and (d) of Article 1(1) of the UABIT. Furthermore, according to Claimant “[b]ecause

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<sup>356</sup> Request, para. 3.

<sup>357</sup> *Id.* at para. 5.

<sup>358</sup> Claimant’s First Post-Hearing Submission, p. 2.

Alpha's assets were contributed to a joint activity, under Article 1134.1 of the Civil Code of Ukraine . . . , Alpha thereupon obtained rights *in rem* – in the form of an interest in movable and immovable property – by reason of its ownership interest in the joint undertaking (simple partnership).”<sup>359</sup> The Tribunal understands Claimant to be arguing that these contributions gave rise to certain rights under the JAAs, and that the rights constitute the protected investment for purposes of the BIT, and form the basis for Claimant's claim for damages based on, among other things, revenue to which it believes it is entitled under the contracts.

260. With respect to the ICSID Convention, Claimant argues that its interests meet the illustrative criteria for an investment that have been established through various arbitral awards, namely that its interests (1) constitute “substantial commitments and outlays” by Claimant; (2) were of sufficient duration; (3) involved “sharing of operational risks”; and 4) were significant “for the economic development or infrastructure” of Ukraine.<sup>360</sup>

261. Respondent objects that Claimant has not made an investment within the terms of the UABIT or the ICSID Convention. It asserts that (1) Claimant did not engage in “economic activity” in the “territory” of Ukraine but instead made payments directly to Pakova in Cyprus; (2) any investments of Claimant were not of a sufficient duration; (3) Claimant “was to receive a stable fixed amount” of monthly income and did not incur risk; (4) in the circumstances of this case, claims to money under Article 1(1)(a) of the UABIT “must be against third parties, but not against an investee;” (5) any investment was not in accordance with law; and (6) no *in rem* property rights were created because there was no legitimate joint activity.<sup>361</sup> Several of these objections relate to a broader objection by Respondent that the commercial arrangements between Claimant and the Hotel did not constitute “joint activity” under Ukrainian law. Given the cross-cutting nature of this objection, the Tribunal shall deal with it first.

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<sup>359</sup> *Id.* Claimant points to the arbitral award in *Helnan* as supporting its claim that contributing to the refurbishment of a Hotel constitutes an “investment.” Claimant's Second Post-Hearing Submission, p. 16.

<sup>360</sup> See Claimant's First Post-Hearing Submission, p. 3 (setting forth these criteria and arguing that Claimant's investment meets them).

<sup>361</sup> See Counter-Memorial, paras. 134-43, 212-56; see also Rejoinder, paras. 9-48; Respondent's First Post-Hearing Submission, paras. 82-88; Respondent's Second Post-Hearing Submission, paras. 3-14.

## **2. Relevance of Whether the Arrangements Amounted to a “Joint Activity”**

262. As explained above, Claimant asserts that its contractual arrangements with the Hotel created a “joint activity” under Ukrainian law. As a consequence, Claimant argues that the sum of its investment interests that have been damaged by Respondent’s actions includes (1) the right to the minimum monthly payments specified in the terms of the contracts; and, (2) upon termination of the “joint activity,” a 50% share in the residual value of the joint activity.<sup>362</sup> Respondent argues extensively that no legitimate “joint activity” was created. Instead, Respondent argues that the arrangements amounted to no more than loan agreements between Claimant and the Hotel and construction contracts with Pakova. Such arrangements do not, according to Respondent, amount to a protected “investment.”

263. As previously noted, the Tribunal will address as part of the merits the question of whether the 1998 and 1999 JAAs and related agreements established (or continued) a “joint activity.” That question, however, is not dispositive for purposes of establishing the existence of an “investment.” Claimant may possess one or both of the economic rights noted in the preceding paragraph as a result of the various contracts even if no joint activity existed. Such rights could in themselves amount to a protected investment, whether or not they arise from a joint activity as that term is defined under Ukrainian law.

## **3. Article 1(1) of the UABIT**

264. In this section, the Tribunal shall examine whether Claimant made an “investment” as that term is defined in the UABIT. The Tribunal will provide its conclusions after examining Respondent’s objections on this point.

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<sup>362</sup> As explained above, Claimant’s expert, Mr. Omelchenko, also asserted that a party to a joint activity has a right to the return of its contribution when the joint activity is dissolved. Claimant did not, however, ultimately make a separate damages claim with respect to its original contribution.

**a. Whether the Contracts Were Merely Loan and Construction Agreements**

265. According to Respondent, Alpha is not entitled to any rights in the assets of the Hotel because the JAAs are not “joint activity agreements” but merely a combination of loan agreements and construction contracts.<sup>363</sup> Respondent does not argue that the JAAs are illegal under Ukrainian law,<sup>364</sup> but only that such “pretended agreements” must be treated as what they (in Respondent’s view) really are.<sup>365</sup> Respondent refers to case precedents in Ukrainian courts in which, according to Respondent, the courts found that certain contracts must be “regulated” as loans regardless of the fact that the agreements were cast as “joint activity agreements.”<sup>366</sup>

266. In support of its position, Respondent argues that the minimum monthly payments under the JAAs were “pure financing with a guaranteed return, which is typical for a loan.”<sup>367</sup> Respondent argues that Claimant and the Hotel accordingly established a relationship that is “characteristic” of creditor and debtor, rather than of investor and investee where each entity has a share in the “future profitability” of the venture.<sup>368</sup> For Respondent, the contract was a straightforward arrangement in which “Alpha paid for the works needed by the Hotel and the latter agreed to repay the loan by the monies received from the renovated rooms.”<sup>369</sup> Respondent also refers to a report prepared by its own expert on damages, EBS, and the opinion of its legal expert, Professor Maydanyk, who contended that the JAAs were part of a loan and construction arrangement rather than a joint activity.<sup>370</sup> Respondent asserts that “a ‘loan’ can not amount to an ‘investment,’ either in general, or under the UABIT. . . .”<sup>371</sup>

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<sup>363</sup> Counter-Memorial, paras. 213-15; *see also* paras. 25, 219 (asserting that the agreements give rise to, if anything, a lender/borrower relationship).

<sup>364</sup> *See id.* at para. 215 (noting that while such disguised agreements “are not illegal *per se*,” they do not result in ownership that might otherwise arise in a legitimate joint activity.)

<sup>365</sup> *Id.* at para. 214.

<sup>366</sup> *Id.*; Rejoinder, para. 72.

<sup>367</sup> Counter-Memorial, para. 234 (emphasis omitted).

<sup>368</sup> *Id.* at para. 143; Respondent’s First Post-Hearing Submission, para. 82 (claiming that what “distinguishes an investment from other transactions is the uncertain returns, subject to the future profitability of a project in which the investor participates”) (emphasis omitted).

<sup>369</sup> Counter-Memorial, para. 28.

<sup>370</sup> Counter-Memorial, paras. 220-21.

<sup>371</sup> Respondent’s First Post-Hearing Submission, para. 178.

267. In response, Claimant argues that the parties understood at the time the agreements were negotiated that they were creating a joint activity, that the Ukrainian government authorities approved the joint activity, and that it was the “Hotel management and . . . Ukrainian State officials” that suggested the “joint activity” framework in the first place.<sup>372</sup> For Claimant, the network of agreements were part of a multi-faceted project, with mutual rights and obligations that in total went far beyond a mere construction contract or loan arrangement.

268. The Tribunal agrees with Claimant that Claimant and the Hotel were engaged in a complex project which was devoted to the renovation of the Hotel over many years and which involved many different types of agreements. It has been alleged that the Hotel itself was a party to no less than eighteen agreements. These various contracts addressed separate phases of the project as far as it got. It is not surprising that in bringing these stages to fruition, more than one type of agreement was necessary, including not only construction contracts between the Hotel and Pakova but also other agreements that spelled out the overall arrangements among the parties for a given stage of the undertaking, such as with respect to profit allocation, duration, guarantees of performance and other rights and obligations.

269. Furthermore, it is not disputed that Claimant and Mr. Kuess were deeply involved in the renovation of the Hotel. Claimant spent approximately USD 3.2 million in furtherance of the project and had to borrow the money to do so,<sup>373</sup> for which it paid nearly USD 2 million in interest through April of 2005.<sup>374</sup> Furthermore, it is not disputed that Claimant “reinvested” over USD 400,000 of what were intended to be accounts receivable owing to Alpha by the Hotel.

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<sup>372</sup> Reply, p. 4 (“All of the relevant parties – Alpha, SE Dnipro Hotel, and the State Committee for Tourism – regarded themselves as engaged in only one project, which had as its goal the redevelopment of the Dnipro Hotel into a deluxe four-star facility. The participants to this renovation and rehabilitation project intended to be, and understood that they were, engaged in a joint undertaking (partnership) under Ukrainian law. Alpha and SE Dnipro entered into, and the State Committee for Tourism approved agreements that were specifically designed to reflect that mutual understanding. The specific form of the agreements was determined by SE Dnipro Hotel management and by Ukrainian State officials.”) (internal citations omitted); *see also* Supplemental Kuess Affidavit, para. 11; Bozhenko Affidavit, paras. 11-13.

<sup>373</sup> *See* Doc. C-204.

<sup>374</sup> *See* Doc. C-176, p. 7; Claimant’s Second Post-Hearing Submission, pp. 2-3.

270. In addition to Alpha's monetary contributions, Mr. Kuess spent considerable time and effort in advancing the standing and the quality of the Hotel. For example, Claimant purchased furniture and equipment for the Hotel. Mr. Tsybuch explained in his letter that the eventual four-star rating for the Hotel "became possible due to the frequent visits of Mr. Kuess . . . to Ukraine which demonstrated his interest and involvement in the development of the hotel business in Ukraine." Ms. Luganova also explained in detail how Mr. Kuess assisted in marketing the Hotel and setting up an on-line room reservation system.<sup>375</sup>

271. Clearly, Claimant entered into these arrangements with the expectation of receiving an economic return that went beyond merely repayment of the money Claimant contributed. Claimant asserts that the expected economic returns include the three aforementioned rights (the right to share the profits, the right to a share of the value of the joint activity, and the right to the return of each party's contribution) that would accrue to it under a "joint activity agreement." While Respondent argues that no legitimate "joint activity" existed, the contracts purport to require the Hotel to split profits with Claimant and, at a minimum, to make the monthly payments specified in the contracts. The contracts themselves are also cast as joint activity agreements. While Respondent challenged the legality of certain provisions in the contracts, it is evident that the parties intended for the arrangements to be something different than a simple borrowing transaction.

272. The Tribunal concludes that it is the character of the project *in toto* which determines the nature of the commercial arrangements and not the individual agreements in isolation. The project involved more than a series of loan agreements and construction contracts.

273. Even if the arrangements between Claimant and the Hotel amounted to no more than loan agreements, however, Claimant's economic contribution and interest in the project would still qualify as an investment protected by the UABIT. The Tribunal is unaware of any ICSID decision that has held that a loan cannot be an "investment," either standing alone or as one facet of a larger enterprise. The Tribunal notes that large infrastructure undertakings regularly involve

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<sup>375</sup> Luganova Affidavit, para. 39.

loans that are part and parcel of a greater endeavor. Claimant cites the *Malaysian Salvors* case for the proposition that a loan can, under proper circumstances, qualify as a protected investment under “longstanding ICSID case law.”<sup>376</sup> The Tribunal agrees that loans may qualify as investments.<sup>377</sup>

274. The Tribunal finds that the commercial arrangements at issue in this case do not constitute simple loan agreements and construction contracts and that, even if they did, that fact alone would not disqualify Alpha’s participation as a protected investment.

**b. Whether Claimant Engaged in “Economic Activity” in Ukraine**

275. In order to qualify as an investment protected by the UABIT, Claimant’s investment must be “in connection with the economic activity of” Claimant in Ukraine.<sup>378</sup> Respondent asserts that Claimant made no such investment because its payments by and large were made directly to Pakova in Cyprus.<sup>379</sup> Furthermore, Respondent argues that, even though certain of Claimant’s payments flowed through an account in Ukraine,<sup>380</sup> “this alone . . . would not have satisfied . . . the ‘in-the-territory’ requirement” if they were not present in Ukraine for some unspecified amount of time.<sup>381</sup>

276. In response, Claimant emphasizes that Article 1(1) of the UABIT speaks of investments made “in connection with the economic activity” of an investor “in the territory of the other Contracting Party.” Claimant cites the “parallel” provisions in Article 1.1 of Ukraine’s FIL as

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<sup>376</sup> Claimant’s First Post-Hearing Submission, p. 21.

<sup>377</sup> See also *Fedax v. Venezuela Fedax N.V. v. Republic of Venezuela*, ICSID Case No. ARB/96/3, Decision of the Tribunal on Objections to Jurisdiction, July 11, 1997, para. 29 (“*Fedax*, Jurisdiction”) (“loans may qualify as an investment within ICSID’s jurisdiction”); *CSOB*, Jurisdiction, at para. 76.

<sup>378</sup> Article 1 of the UABIT.

<sup>379</sup> Tr. 1, p. 50, lines 21-24; Counter-Memorial, para. 136.

<sup>380</sup> With respect to floors 8-10, upon the execution of the 1999 JAA, Claimant transmitted the amount required to compensate Pakova to a bank account in the name of the 1999 JAA in Ukraine. These funds were then transferred into an account that Pakova maintained in a bank in Athens, Greece. The Respondent charges, however, that Alpha’s contribution of approximately US \$1,700,000 to the 1999 JAA was “present on the territory of Ukraine for only several days. . . .” Counter-Memorial, para. 219.

<sup>381</sup> Respondent’s First Post-Hearing Submission, para. 103.



supporting the proposition that the proper inquiry is “whether the investment activity was ‘within the territory’ of Ukraine, not to whether the investment itself occurred within Ukraine.”<sup>382</sup>

277. For Claimant, Pakova’s construction work (which, of course, took place in Kiev) was an essential part of the joint activity in Ukraine. Claimant contends in this regard that the protected “activity” that came into being “in the territory” of Ukraine in this instance was the rehabilitation of the Hotel and not the route the payments took. Claimant asserts that the fact that “certain payments may have been made outside of Ukraine is irrelevant. The benefits of those payments . . . were experienced in Ukraine.”<sup>383</sup> Claimant concludes that when a “foreign entity invests assets as part of the process of engaging in economic activity” in Ukraine, that “process” and that “activity” are taking place “in the territory” of Ukraine for purposes of the UABIT, regardless of the actual money flow.<sup>384</sup>

278. Both parties commented on ICSID case law interpreting treaty requirements that an investment be “in the territory” of the respondent state. Claimant cited the tribunal’s conclusion in *SGS v. Philippines* that an investment “could not be analyzed as a series of separate components for purposes of deciding where the investment had occurred.”<sup>385</sup> Claimant likewise referred to *Fedax v. Venezuela* for its “recognition of the modern reality that the flow of funds cannot be determinative of where an investment is made,” but rather that it is “where the benefits of the investment” are located that ought to decide whether it is made “in the territory” of the host State.<sup>386</sup> Respondent, on the other hand, rejected Claimant’s reliance on these cases as “irrelevant because of different factual circumstances and legal framework.”<sup>387</sup>

279. The Tribunal agrees with Claimant that, for purposes of the UABIT, it is the “activity” that must take place “in the territory” of Ukraine and not necessarily the flow of funds that allows that “activity” to take place. In the words of the *SGS v. Philippines* tribunal, the location

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<sup>382</sup> Claimant’s First Post-Hearing Submission, p. 6.

<sup>383</sup> *Id.*

<sup>384</sup> *Id.* at p. 5.

<sup>385</sup> *Id.* (citations omitted).

<sup>386</sup> *Id.*, citing *Fedax*, Jurisdiction, at para. 41.

<sup>387</sup> Respondent’s Second Post-Hearing Submission, para. 8.

of the project in question constitutes the “center of gravity” and the “focal point” insofar as the territorial dimension of an “investment” is concerned.<sup>388</sup>

280. Respondent has not contested that Alpha engaged in a business relationship with the Hotel located in Ukraine. Respondent further acknowledges that Alpha expended money towards the renovation and improvement of the Hotel, that Mr. Kuess spent significant time and effort working with the Hotel in Ukraine, that payments by and to Claimant were made pursuant to contracts with a Ukrainian entity (although Respondent does argue that specific payment flows were in violation of those contracts, as discussed below), that the contracts were governed by Ukrainian law, and that the economic benefits Claimant was to receive were to be derived from the Hotel’s commercial activity in Ukraine.

281. Respondent’s argument boils down to the proposition that, because certain of Claimant’s payments were made directly to Pakova in Cyprus, or were made to an account in Ukraine only to be quickly transferred elsewhere, Claimant did not in fact make an investment in Ukraine. However, the fact remains that the relevant economic activity took place in Ukraine. It would be elevating form over substance to assert that, in order for Alpha’s payments to qualify as an investment under the UABIT, Claimant would first have to transfer money to Ukraine, ensure that the money resided in Ukraine for some requisite period of time, and then have the money transferred to the company performing the work in Ukraine, whose accounts happened to be located in Cyprus.

282. While not necessary to the Tribunal’s finding, the Tribunal does not believe that Claimant acted improperly in making the payments in the manner it did. The payments related to floors 11-12 were made pursuant to several different contracts, including the First, Second, and Third

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<sup>388</sup> *SGS Société Générale de Surveillance S.A. v. Republic of the Philippines*, ICSID Case No. ARB/02/6, Decision on Jurisdiction, January 29, 2004, paras. 101-12 (“*SGS, Jurisdiction*”) (holding that the “focal point of SGS’s services was the provision, in the Philippines, of” certain services, and the fact that other services and payments were made outside the Philippines did not change the tribunal’s conclusion that the investment was made “in the territory” of the Philippines). While not necessary to its decision, the Tribunal also notes that it perceives no incompatibility in this regard between the provisions of the UABIT and those of the 1996 FIL. Like the UABIT, the FIL places the emphasis upon the locus of the “activity,” not upon the place of payment or receipt of funds. *See* Doc. C-13 at Art. 1(1) (defining a foreign investor as a person “engaged in investment *activity* in the territory of Ukraine”) (emphasis added).

General Agreements. The First General Agreement does not specify that Alpha's payments must take place in Ukraine or in any other designated situs, but simply requires that Claimant make bank transfers to Pakova. The Second General Agreement also does not specify where payments are to be made.

283. The Third General Agreement does specify that Alpha was to make payments to the Hotel's account in "Ukreksimbank, Kiev." However, while the record indicates that Claimant instead made payments directly to Pakova, it apparently did so pursuant to the Hotel's express instructions. Claimant provided five payment authorizations from the Hotel stating that they relate to payments under the Third General Agreement.<sup>389</sup> All of them are signed by both the "Director" of the Hotel and its "Chief Accountant," and direct Claimant to make payments to Pakova's account in Cyprus. A sixth letter refers to the Second General Agreement, but similarly instructs that the payment be made directly to Pakova's account in Cyprus. At no time did Respondent contest the authenticity or the contents of these letters. While Respondent alleged that the payments under the Third General Agreement were in "violation of the currency control regulations,"<sup>390</sup> it never provided a clear explanation of why it believed that to be the case, much less any legal authority in support of that proposition.

284. With respect to the 1999 JAA, the agreement states that all "operations" of the joint activity were "to be executed through the separate settlement account . . . to be opened with the 'Kreditanshtalt – Ukraina' Joint-Stock Commercial Bank."<sup>391</sup> The record indicates that Claimant paid USD 1,701,620 into such an account,<sup>392</sup> and the payment was registered by Ukrainian governmental authorities on July 30, 1999.<sup>393</sup> Respondent complains that the funds remained in that account for only a short period of time. However, the 1999 JAA did not mandate that the money remain in the Ukrainian bank account for any period of time. To the contrary, the agreement expressly grants the "right" to dispose of such "assets" to the general manager of the

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<sup>389</sup> Doc. C-125.

<sup>390</sup> Counter-Memorial, para. 30.

<sup>391</sup> Doc. C-132, Art. 3.3.

<sup>392</sup> Claimant provided a wire transfer record (Doc. C-139) indicating that it paid USD 1,701,620 into such an account, and the Respondent produced a "certificate" (Doc. R-11) from "Bank Austria Creditanstalt Ukraine" confirming its receipt of the payment for deposit into an account named "agreement on joint and investment activity 04.06.99."

<sup>393</sup> Doc. C-140.

Hotel, without restriction. For these reasons, the Tribunal concludes that Respondent has no legitimate grounds for complaining about the routing of the proceeds of Alpha's contribution to the 1999 JAA.

285. In summary, the Tribunal finds that the locus of the relevant economic activity was in Ukraine and that Alpha's payments related to Pakova's work on floors 8-12 of the Hotel were "in connection with the economic activity of [Claimant] in the territory of" Ukraine.

**c. Whether Claims to Money Referenced in Article 1(1)(c) Must Be Against Third Parties**

286. Respondent argues that Claimant has no "claim to money" that qualifies as an investment because Claimant's claim runs against the "investee," by which Respondent appears to mean the joint activity or possibly the Hotel. Respondent explains that "[a] claim to money can only be a useful positive contribution to any joint activity when such claim is directed against a third party, and not against other participants of joint activity, since the latter claim to money does not add anything positive to the joint activity and its property (assets), and even deducts therefrom."<sup>394</sup> The Tribunal does not accept this argument.

287. First, Respondent's argument appears to be directed at the question of whether Claimant made a legitimate contribution to a "joint activity" rather than whether Claimant has made an investment. Even if the money did not constitute a contribution to the joint activity, it could still constitute an investment under the terms of the UABIT.

288. Second, the purpose of the payments was to pay for the reconstruction and renovation of the Hotel in order to make it more attractive to customers, to increase occupancy and room rates, and thereby to enhance the Hotel's revenue stream over the long term. In return, Claimant had a right to a share of that revenue stream. At a minimum, Claimant's rights fit squarely within Article 1(1)(c) of the UABIT, which identifies as one type of investment a "[c]laim to money which has been given in order to create an economic value . . . ." Alpha's expenditures were

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<sup>394</sup> Counter-Memorial, n.103; *see also* Rejoinder, para. 14; Respondent's First Post-Hearing Submission, para. 85.

clearly “given” in hopes of “creating an economic value” by increasing the Hotel’s income or capital or both. Alpha’s “claim” is represented by its right to monthly payments from the Hotel under the terms of the 1998 and 1999 JAAs, and possibly other economic rights as well, as discussed elsewhere. There is nothing in Article 1(1)(c) that imposes the type of limitation Respondent suggests.

**d. Whether the Alleged Investment Was in Accordance with Law**

289. In order for Claimant’s alleged investment to fall within the definition set forth in Article 1(1) of the UABIT, the investment must have been “invested . . . in accordance with the law and regulations of” Ukraine. Respondent argues that Claimant’s alleged investment was not made “in accordance with” such laws and regulations and, therefore, is not an investment protected by the UABIT.<sup>395</sup> Respondent cites several cases in support of its position that, in order to be protected by a BIT, an investment must be “invested” in accordance with the law of the host country.<sup>396</sup>

290. In support of its allegation that the investments were not “invested” in accordance with law, Respondent argues that (1) several of the agreements between Claimant and the Hotel were backdated, as described in section IV.A.1 above; (2) the registration of the agreements and alleged investments was improper; and (3) the minimum monthly payment obligations under the 1998 and 1999 JAAs were impermissible.

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<sup>395</sup> Rejoinder, para. 21.

<sup>396</sup> Respondent cites *Inceysa v. El Salvador*, ICSID Case No. ARB/03/26, Award, August 2, 2006 (“*Inceysa*”) and *Fraport v. Philippines*, ICSID Case No. ARB/03/25, Award, August 16, 2007 (“*Fraport*”), for the proposition that tribunals have “soundly declined jurisdiction on the grounds of non-compliance with provisions concerning ‘in accordance with the laws.’” See Rejoinder, para. 23. Respondent cites *Inceysa* for the “uncontroversial” proposition that “respect for the law is a matter of public policy . . . in any civilized country.” See Rejoinder at para. 24 (citing *Inceysa* at para. 248). Respondent refers to *Fraport* as acknowledging that “an economic transaction that might qualify *factually* and *financially* as an investment . . . falls, nonetheless, outside the jurisdiction of the tribunal” as a result of that transaction’s failure to comply with host State law. See Rejoinder, para. 25 (citing *Fraport* at para. 306). Respondent finds further support for this conclusion in the *Plama* case. See Rejoinder, para. 28.

**(i) Backdated Documents**

291. With respect to Respondent's first objection, the Tribunal addressed Respondent's allegations of backdating at length in section IV.A.1 above. The Tribunal will not repeat the relevant arguments and conclusions here, except to note that the pre-1998 agreements that were allegedly backdated are not relevant to the Tribunal's decision on jurisdiction. Those agreements were superseded by the 1998 JAA, and the 1998 JAA and subsequent agreements form the basis of Claimant's claims.

**(ii) Registration**

292. Respondent argues that Alpha's "investment" was "fraudulently registered"<sup>397</sup> and rejects Claimant's assertion that registration immunizes an investment from any future challenge as to its legitimacy.<sup>398</sup> Respondent also observes that, under the FIL, it is the "investment" rather than the "agreements" that must be registered under a "special separate procedure" in order to obtain protection under the FIL.<sup>399</sup> Respondent argues that Alpha's expenditures for the top floor renovations were not "covered" by the FIL after October 24, 1998, the date of the execution of the 1998 JAA, because the earlier expenditures by Alpha were "not re-registered" as they "should have been."<sup>400</sup> Respondent argues that the investments pursuant to the 1999 JAA were also not properly registered.<sup>401</sup>

293. As early as the Request for Arbitration, Claimant asserted that its investments were "duly registered,"<sup>402</sup> including the USD 1,528,180 for the top floors on January 15, 1997;<sup>403</sup> the USD 1,701,620 for floors 8-10 on July 30, 1999;<sup>404</sup> and the USD 447,569.09 as a "reinvestment" on December 25, 2003.<sup>405</sup> In addition, as part of its document production, Claimant provided

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<sup>397</sup> Counter-Memorial, paras. 47, 56.

<sup>398</sup> See Rejoinder, para. 77. Respondent also quoted passages from the *Generation Ukraine* Award as saying "nothing about any 'preclusive effect' of state registration." Rejoinder, para. 99.

<sup>399</sup> Counter-Memorial, para. 104.

<sup>400</sup> *Id.* at para. 106.

<sup>401</sup> *Id.* at para. 107.

<sup>402</sup> Request, p. 3.

<sup>403</sup> Doc. C-121.

<sup>404</sup> Doc. C-140.

<sup>405</sup> Doc. C-163; Request, p. 3.

evidence of 12 separate registrations in Ukraine that took place between 1997 and 2003.<sup>406</sup> As noted in the fact section, Claimant argues that registration immunizes the contracts and investments from further challenges to their legitimacy.

294. The Tribunal first notes that there are unanswered questions regarding certain of the registrations. For example, Respondent asserts that Claimant should have re-registered its investments in floors 11-12 after the negotiation of the 1998 JAA since the original registration referred only to the 1994 JAA. Respondent similarly argues that the investment in floors 8-10 should have been re-registered after the 1999 JAA was extended. Respondent cited no authority for this conclusion, although Claimant did not rebut it either. Even assuming that the investments should have been re-registered, however, Respondent has not explained why any alleged such errors render the investments illegal under Ukrainian law. While Respondent argues that a faulty registration may deprive the investments or agreements of protection under the FIL, it does not articulate why the investments or agreements would be rendered *illegal* such as to deprive the Tribunal of jurisdiction over Claimant's claims.

295. Second, Respondent has not produced any court or administrative decision demonstrating that the registration documents that were filed were, in fact, improper. In this regard, the Tribunal notes the reasoning of the arbitration award in *Generation Ukraine v. Ukraine*,<sup>407</sup> to which both parties cite.<sup>408</sup> In that proceeding, Ukraine challenged the registration of an investment in a corporate entity as defective under Ukrainian domestic law. The tribunal concluded: "Respondent has not produced any decision of a competent Ukrainian court on the validity of the state registration . . . . In these circumstances, the tribunal must accept the status quo of [the corporation's] effective existence as a Ukrainian legal entity because this Tribunal has no jurisdiction to investigate and rule upon the alleged formal defect raised by

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<sup>406</sup> Docs. C-121, 122, 129, 132, 134, 136, 140, 144, 159, 160, 162 and 163.

<sup>407</sup> *Generation Ukraine v. Ukraine*, ICSID Case No. ARB/00/9, Award, September 16, 2003 ("*Generation Ukraine*").

<sup>408</sup> See Rejoinder, paras. 97-100; Reply, p. 10.

Respondent.”<sup>409</sup> This Tribunal reaches a similar conclusion with respect to the submitted registration documents.

296. Lastly, the Tribunal notes that both parties refer to the decision in *Tokios Tokelés v. Ukraine* (ICSID Case No. ARB/02/18, Decision on Jurisdiction, April 29, 2004). Article 1(1) of the Ukraine-Lithuania BIT at issue there defined “investment” in part as “every kind of asset invested by an investor of one Contracting Party in the territory of the other Contracting Party in accordance with the laws and regulations of the latter . . .”, verbiage which is almost identical to the language set forth in Article 1(1) of the UABIT. As here, Respondent Ukraine in *Tokios* argued that “even if Claimant is judged to have made investments in Ukraine, those investments were not made in accordance with Ukrainian law and thus are not covered” by the BIT in question.<sup>410</sup>

297. In *Tokios*, Ukraine alleged that it had “identified errors in the documents provided by Claimant . . . ,”<sup>411</sup> though it did not allege that “Claimant’s investment and business activity . . . [were] illegal *per se*.”<sup>412</sup> Nevertheless, it alleged that “some of the documents underlying these registered investments contain defects of various types, some of which relate to matters of Ukrainian law.”<sup>413</sup> The *Tokios* tribunal concluded that, “[e]ven if we were able to confirm Respondent’s allegations, which would require a searching examination of minute details of administrative procedures in Ukrainian law, to exclude an investment on the basis of such minor errors would be inconsistent with the object and purpose of the Treaty. In our view, Respondent’s registration of each of Claimant’s investments indicates that the ‘investment’ in question was made in accordance with the laws and regulations of Ukraine.”<sup>414</sup> The *Tokios* tribunal concluded that, “if the assets were in reality investments within the meaning of the Investment Treaty[,] a failure to observe bureaucratic formalities of the domestic law could not

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<sup>409</sup> *Generation Ukraine* at para. 9.3.

<sup>410</sup> See *Tokios Tokelés v. Ukraine*, ICSID Case No. ARB/02/18, Decision on Jurisdiction, April 29, 2004, at para. 72 (“*Tokios*, Jurisdiction”).

<sup>411</sup> *Id.* at para. 83.

<sup>412</sup> *Id.* at para. 86.

<sup>413</sup> *Id.*

<sup>414</sup> *Id.*



have caused their character to change.”<sup>415</sup> This Tribunal agrees with the rationale of the tribunal in *Tokios* in reaching its own conclusion that Claimant’s investment is not excluded from the Tribunal’s jurisdiction by virtue of alleged defects in Claimant’s registration paperwork.

### (iii) Legality of the Joint Activity Agreements

298. In addition to challenging the existence of a joint activity, Respondent makes certain other allegations regarding the legality of the agreements. For purposes of establishing the Tribunal’s jurisdiction, Respondent’s objections are only relevant to the extent that the matters Respondent raises render the alleged investment illegal under Ukrainian law and, therefore, not “in accordance with the laws and regulations” of Ukraine. The Tribunal concludes that the agreements do not violate that law.

299. First, Respondent relies on Mr. Rozenblit’s September 1996 conclusion that the 1994 JAA and its amendments “did not comply with the laws” of Ukraine.<sup>416</sup> On this basis, Respondent argues that there was no joint activity between Alpha and the Hotel, and that certain of the legal defects Mr. Rozenblit cites were not immediately “remedied, such as separate bookkeeping.”<sup>417</sup> Consequently, Respondent argues, the “improvements” that were carried out on the top floors of the Hotel were “not acquired or created as a result of joint activity.”<sup>418</sup> As Claimant points out, Mr. Rozenblit issued a second opinion after the 1996 JAA was concluded indicating that the new arrangements were legal. Furthermore, the deficiencies cited by Mr. Rozenblit related to responsibilities of the Hotel, not to those of Alpha. More to the point, however, Mr. Maydanyk conceded that any errors in the 1994 JAA were subsequently cured by the 1998 JAA, as explained above. Accordingly, the status of the 1994 JAA is not a basis for finding Claimant’s investments to be illegal under Ukrainian law.

300. Second, Respondent charges that various certificates of performance with regard to the reconstruction work on floors 8-10 were “maliciously fabricated.” This issue is addressed at

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<sup>415</sup> *Tokios*, Award at para. 97.

<sup>416</sup> Respondent’s Second Post-Hearing Submission, para. 16.

<sup>417</sup> Respondent’s First Post-Hearing Submission, para. 35 (pointing out that the lack of separate bookkeeping was noted in 1998, two years after Rozenblit issued his legal opinion).

<sup>418</sup> *Id.*

length in the fact section, and the discussion will not be repeated here except to note that the Tribunal concludes that the record does not support a finding of fraud.

301. Third, Respondent objects to the extension of the terms of the 1998 and 1999 JAAs to 2015. According to Respondent, the extension of the 1999 JAA constituted an act of “roguery” by Claimant.<sup>419</sup> Mr. Melnikov, who has never been a member of the Ukraine bar and who worked at the State Administration of Affairs before becoming a senior official at the Hotel in 2005, criticized the legitimacy of the extension of the 1998 JAA. Mr. Melnikov recounted at the Hearing that it was his “personal conclusion,” rather than a determination by any government “Commission,” that the extension of the contract term to 2015 was “illegal.”<sup>420</sup> He went on to state that, “[y]ou can’t prolongate the joint activity without any reason according to our legislation . . . I made a conclusion that the prolongation . . . will result in \$5.4 million of illegal benefits” to Alpha.<sup>421</sup>

302. Mr. Melnikov’s conclusion that the extension of the 1998 JAA was impermissible appears to be based on his belief that the terms of the contract extensions were unreasonable. However, that conclusion does not support a finding that the extensions were illegal under Ukrainian law, at least based on the record presented. To the contrary, Ms. Luganova testified that the extension had received the explicit approval of the State Tourist Administration.<sup>422</sup> Accordingly, the Tribunal does not consider the prolongation of the contracts to be a basis for finding Claimant’s investment to be illegal under Ukrainian law, although, as explained further below, the Tribunal has also concluded that the terms of the JAAs must be reformed.

**e. Conclusion as to Whether Claimant Has Made an  
“Investment” for Purposes of Article 1 of the UABIT**

303. The Tribunal concludes that Claimant has made an “investment” as that term is defined in the UABIT. First, the Tribunal concludes that, at a minimum, Claimant has a “claim to money which has been given in order to create an economic value,” and therefore has an investment

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<sup>419</sup> Counter-Memorial, para. 100.

<sup>420</sup> Tr. 4, p. 69, lines 20-25; p. 70, lines 1-9.

<sup>421</sup> *Id.* at p. 71, lines 4-6, 12-14, 19.

<sup>422</sup> Tr. 2, p. 72, lines 8-16.

under Article 1(1)(b) of the UABIT. Claimant’s “claim to money” includes at least its claim to a share of the profits of the project and/or the minimum monthly payments. This finding alone is sufficient to meet the jurisdictional requirement that Claimant prove the existence of an investment.

304. Claimant has, however, also asserted that it has made an investment under Article 1(1)(a) (“movable and immovable property as well as any other rights *in rem*”) and 1(1)(d) (“intellectual and industrial property rights”). With respect to Article 1(1)(a), Claimant relies, for example, on Articles 1130, 1133 and 1134 of the Ukraine Civil Code for the proposition that participants in a joint activity have “an equal, indivisible ownership interest in that joint activity property,”<sup>423</sup> with the result that Alpha is entitled to its share in all the “attributes” of that ownership right. Claimant further supports its position by reference to the written submissions and oral testimony of its legal expert, Professor Omelchenko. Respondent objects to the existence of an investment under Article 1(1)(a) on grounds that Claimant has not established the existence of a legitimate joint activity.<sup>424</sup> The Tribunal will discuss the extent of Claimant’s rights under the alleged joint activity in sections VIII-IX below.

305. As regards subparagraph (d), Claimant did not assert that it possesses patents, copyrights, trademarks and other specified intellectual property rights that are protected either by domestic Ukrainian statutes or international conventions. Claimant argues, however, that Mr. Kuess shared his personal “know-how” in the hotel business gained on the basis of his many years of experience in the industry. Respondent does not seriously contest that the Dnipro Hotel materially benefitted from Mr. Kuess’ expertise.

306. The Tribunal concludes that Mr. Kuess’s advice to the Hotel is not an investment under Article 1(1)(d). While that provision includes “know how” in the list of intellectual or industrial property rights that qualify as investments protected under the UABIT, the type of assistance provided by Mr. Kuess is not of the same nature as the rights indicated. Claimant has not proven that the conveyance of Mr. Kuess’s advice in itself resulted in the creation of any economic or

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<sup>423</sup> Claimant’s First Post-Hearing Submission, p. 10.

<sup>424</sup> See Respondent’s Second Post-Hearing Submission, para. 4.

legal rights. In any case, even if Mr. Kuess' "know how" constituted an investment, such investment would not entitle Claimant to any additional compensatory rights than it would otherwise possess were its investment limited to "claims to money," *in rem* interests in the joint activity, or the other "assets" Claimant has asserted that it possesses.

307. Finally, the Tribunal reiterates that the list of investments in Article 1(1) (a)-(e) is illustrative and that the definition in Article 1(1) encompasses "every kind of asset" without limitation. Even if Claimant's alleged investments did not fall within subparagraphs (a)-(e) of the illustrative list, the Tribunal concludes that Claimant's economic rights are "assets" within the meaning of Article 1(1). Such assets include Claimant's rights under the 1998 JAA, the 1999 JAA, the Additional Agreement No. 1 to the 1998 JAA, the Additional Agreement No. 3/03 to the 1998 JAA, and the "reinvestment" that Alpha made in 2003.<sup>425</sup> All of these rights are, however, subject to the additional qualifications discussed in section VIII below.

308. The Tribunal recalls the conclusion of the *Tokios* tribunal, which interpreted the Lithuania-Ukraine BIT, which also included the words "every kind of asset" in its definition of the term "investment." The tribunal reasoned that "an investment under the BIT is read in ordinary meaning as 'every kind of asset' for which 'an investor of one Contracting Party' caused money or effort to be expended and from which a return or profit is expected in the territory of the other Contracting Party."<sup>426</sup> This Tribunal is persuaded that the same rationale applies under the facts of this case. Claimant made an expenditure of money related to the renovation of the Hotel in Ukraine, on the basis of which it acquired rights giving it the expectation of an economic return under the terms of the contracts negotiated with the Hotel. These arrangements clearly constitute an "asset" under the terms of Article 1(1) of the UABIT.

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<sup>425</sup> With respect to the reinvestment, the Tribunal recalls the finding in *Tokios* where the tribunal reviewed similar but not identical language in the Ukraine-Lithuania BIT and concluded that, under the "definition of 'investment' in Article 1(1), 'every kind of asset invested by an investor' certainly includes reinvestments of the profits generated by the initial investments." *Tokios*, Jurisdiction at n.71. In this case, the "reinvestment" emanated from changes in the accounting treatment of items on the Hotel's balance sheet so as to avoid otherwise applicable Ukrainian taxes. The Tribunal finds the reasoning in *Tokios* to be equally applicable here.

<sup>426</sup> *Tokios*, Jurisdiction at para. 75.

309. For the aforementioned reasons, the Tribunal concludes that the 1998 and subsequent agreements referenced above, along with Claimant’s expenditures directed at particular floors of the Hotel and the “reinvestment,” fall within some of the categories elaborated in subparagraphs (a) through (e) of Article 1(1) of the UABIT and, more generally, are “assets” falling within the scope of Article 1(1).<sup>427</sup>

#### 4. ICSID Convention

310. In order to determine whether the Tribunal has jurisdiction over this dispute, it is also necessary to determine whether Claimant’s alleged investment qualifies as an “investment” as that term is used in the ICSID Convention. Inasmuch as there is overlap between this analysis and the analysis above with respect to the question of whether Claimant has made an “investment” under the UABIT, that analysis is incorporated here.

311. As noted, the ICSID Convention does not define the term “investment.” Given the absence of a definition, both parties refer to illustrative criteria developed in various arbitration awards, most notably the award in *Salini v. Morocco*.<sup>428</sup> However, the elements of the so-called *Salini* test, which some tribunals have applied mandatorily and cumulatively (*i.e.*, if one feature is missing, a claimed investment will be ruled out of ICSID jurisdiction), are not found in Article 25(1) of the ICSID Convention. In applying the criteria in this manner, these tribunals have sought to apply a universal definition of “investment” under the ICSID Convention,<sup>429</sup> despite the fact that the drafters and signatories of the Convention decided that it should not have one.<sup>430</sup>

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<sup>427</sup> The Tribunal notes that Respondent argues that the term “invested” that appears in the definition of “investment” in Article 1(1) of the UABIT is “crucially different from ‘owned’ or ‘controlled’, ‘established’ or ‘acquired.’” Counter-Memorial, para. 135. Whether or not there is any meaningful difference among those terms, the Tribunal concludes that Alpha’s contributions qualify as an “investment” in its ordinary meaning in that it involved a contribution of resources to acquire assets in the expectation of economic gain, as explained above.

<sup>428</sup> See, e.g., Reply, p. 12, n. 6 (citing, *inter alia*, *Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco* (ICSID Case No. ARB/00/4)); Counter-Memorial, p. 38, para. 130, n. 139. These criteria call for consideration of whether the investor contributed money or other assets of value, whether the contribution was for a sufficient duration, whether it involved risk, and whether it contributed to the host State’s development.

<sup>429</sup> See, e.g., *Joy Mining Machinery Ltd. v. Arab Republic of Egypt*, ICSID Case No. ARB/03/11, Award on Jurisdiction, August 6, 2004, para. 53; *Victor Pey Casado and President Allende Foundation v. Republic of Chile*, ICSID Case No. ARB/98/2, Award, May 8, 2008, para. 232; *Patrick Mitchell v. Democratic Republic of the Congo*, ICSID Case No. ARB/99/7, Decision on the Application for Annulment of the Award, November 1, 2006, paras. 29, 33.

<sup>430</sup> See Report of the Executive Directors of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, 1 ICSID Reports 29 at para. 27 (“No attempt was made to define the term

This Tribunal will not follow that approach and will not impose additional requirements beyond those expressed on the face of Article 25(1) of the ICSID Convention and the UABIT.

312. The Tribunal is particularly reluctant to apply a test that seeks to assess an investment's contribution to a country's economic development. Should a tribunal find it necessary to check whether a transaction falls outside any reasonable understanding of "investment," the criteria of resources, duration, and risk would seem fully to serve that objective. The contribution-to-development criterion, on the other hand, would appear instead to reflect the consequences of the other criteria and brings little independent content to the inquiry.<sup>431</sup> At the same time, the criterion invites a tribunal to engage in a *post hoc* evaluation of the business, economic, financial and/or policy assessments that prompted the claimant's activities. It would not be appropriate for such a form of second-guessing to drive a tribunal's jurisdictional analysis.

313. The Tribunal recognizes that elements discussed in the *Salini* test might be of some use if a tribunal were concerned that a BIT or contract definition of "investment" was overreaching and captured transactions that manifestly were not investments under any acceptable definition. Indeed, a number of tribunals and *ad hoc* committees have treated the *Salini* elements as non-binding, non-exclusive means of identifying (rather than defining) investments that are consistent with the ICSID Convention.<sup>432</sup> However, in most cases – including, in the Tribunal's view, this one – it will be appropriate to defer to the States' definition of investment in a BIT or a contract.

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'investment' given the essential requirement of consent by the parties..."); see also *Malaysian Historical Salvors Sdn. Bhd. v. Government of Malaysia*, ICSID Case No. ARB/05/10, Decision on the Application for Annulment, April 16, 2009, paras. 63-71 ("*Malaysian Salvors*, Annulment") (reviewing the *travaux préparatoires* of the ICSID Convention with respect to the definition – or lack thereof – of the term "investment").

<sup>431</sup> Apparently this fourth criterion (contribution to the host state's economic development) was, in fact, originally proposed as a more flexible alternative to the first three criteria. However, the *Salini* tribunal and those following it have added it as a fourth required element in the definitional test. See Emmanuel Gaillard, *Identify or Define? Reflections on the Evolution of the Concept of Investment in ICSID Practice*, in INTERNATIONAL INVESTMENT LAW FOR THE 21<sup>ST</sup> CENTURY 405-406 (2009).

<sup>432</sup> See, e.g., *Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania*, ICSID Case No. ARB/05/22, Award, July 24, 2008, paras. 312-18; *Malaysian Salvors*, Annulment, paras. 75-79; cf., *MCI Power Group, LC and New Turbine, Inc. v. Republic of Ecuador*, ICSID Case No. ARB/03/6, Award, July 31, 2007, para. 165; *RSM Production Corp. v. Grenada*, ICSID Case No. ARB/05/14, Award, March 13, 2009, paras. 236-38; *CSOB*, Jurisdiction at para. 90 (stating that while the "elements of the suggested definition . . . tend as a rule to be present in most investments, [they] are not a formal prerequisite for the finding that a transaction constitutes an investment as that concept is understood under the Convention").

314. Of course, the Tribunal does not contend that *any* definition of “investment” that might be agreed by States in a BIT (or by a State and an investor in a contract) must constitute an “investment” for purposes of Article 25(1). To cite the classic example, a simple contract for the sale of goods, without more, would not constitute an investment within the meaning of Article 25(1), even if a BIT or a contract defined it as one. However, when the State party to a BIT agrees to protect certain kinds of economic activity, and when the BIT provides that disputes between investors and States relating to such activity may be resolved through ICSID arbitration, it is appropriate to interpret the BIT as reflecting the State’s understanding that that activity constitutes an “investment” within the meaning of the ICSID Convention as well. That judgment, by States that are both parties to the BIT and Contracting States to the ICSID Convention, is entitled to great deference.<sup>433</sup> A tribunal would have to have very strong reasons to hold that the States’ mutually agreed definition of investment should be set aside.

315. The Tribunal considers that the UABIT’s offer of ICSID arbitration for investments covered by Article 1(1) of the UABIT may fairly be taken as confirmation by Ukraine (and Austria) that they mutually believe that all such covered investments are “ICSID investments” as well. Nothing in the UABIT’s definition of investment would support characterizing it as an aberration that risks capturing economic activity outside the ICSID Convention’s intended reach. Accordingly, the Tribunal shall proceed on the basis that, where a claimed investment satisfies the UABIT’s definition of investment (as we have held above that it does here), it is also consistent with the ICSID Convention’s understanding of investment.

316. Nevertheless, given that the parties have spent considerable time arguing about whether Claimant’s investment meets the *Salini* criteria, the Tribunal shall briefly address them. In short, however, we see nothing in the *Salini* criteria as applied here to create any concern that the UABIT definition covers transactions that would not be deemed investments for purposes of the ICSID Convention.

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<sup>433</sup> Cf. *Rompetrol Group N.V. v. Romania*, ICSID Case No. ARB/06/3, Decision on Respondent’s Preliminary Objections on Jurisdiction and Admissibility, April 18, 2008, paras. 81, 83 (adopting similar approach with respect to criteria of nationality).

**a. Whether the Investment Was of Sufficient Duration**

317. Respondent contends that “Alpha’s contributions” did not have “reasonably sufficient duration” in Ukraine. With respect to expenditures under the 1998 JAA, Claimant made payments directly to Pakova in Cyprus. With respect to expenditures under the 1999 JAA, Respondent argues that Alpha’s payments were “almost immediately transferred to Pakova,” thereby breaching Alpha’s commitment “to keep its capital investment intact throughout the contract period.”<sup>434</sup> Respondent misconstrues the nature of the commercial arrangements at issue.

318. The routing of the payments to Pakova is discussed at length above (in section VI.D.3.b) and that analysis will not be repeated here. Suffice it to say for present purposes, the locus of the commercial activity in this case was Ukraine, and that activity took place over an extended period of time. The construction and renovation activities, Claimant’s commitment of capital, and the terms of the relevant contracts all extended for many years. In fact, the terms of the underlying agreements are not set to expire until 2015, more than twenty years after Mr. Kuess first arrived in Kiev looking for business opportunities, and over 15 years after the 1998 and 1999 JAAs were executed. Mr. Kuess visited Ukraine regularly for over a decade in relation to the project, and Ms. Luganova provided extensive testimony regarding Alpha’s ongoing assistance to the Hotel for many years.<sup>435</sup> The Tribunal finds that Claimant contributed assets for a sufficient duration and, therefore, its investment meets this particular *Salini* criterion.

**b. Whether Claimant Assumed Risk**

319. Respondent argues that the fixed minimum monthly payments to Alpha under the 1998 and 1999 JAAs insulated Alpha from any risk of “poor performance” or “bad results.”<sup>436</sup> Claimant, on the other hand, emphasizes the inherent riskiness of the venture, noting that, especially in light of the turmoil in Ukraine in the years following the collapse of the Soviet Union, there was “no guarantee that the joint activities would realize returns.”<sup>437</sup> Claimant

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<sup>434</sup> Counter-Memorial, para. 236.

<sup>435</sup> Luganova Affidavit, paras. 39-42.

<sup>436</sup> Counter-Memorial, para. 143.

<sup>437</sup> Claimant’s First Post-Hearing Submission, p. 3.



argues that the 2000 suspension of payments under the 1998 JAA is “indisputable” confirmation of the investment risk that Alpha assumed.<sup>438</sup>

320. The Tribunal agrees that Claimant’s participation in the venture with the Hotel carried commercial risks. Claimant was investing in Ukraine at a time of great political, legal and commercial uncertainty. Ukraine’s economy was experiencing negative growth at least from 1993 through 1999, and the country was suffering from high inflation and high interest rates, and carried a high risk premium.<sup>439</sup> Ms. Luganova testified, and the Tsybuch letter confirmed, that the Hotel could not find other investors apart from Alpha.<sup>440</sup> All of these elements demonstrate the riskiness of Claimant’s investments.

321. While not critical to the Tribunal’s finding that Alpha’s investments were subject to risk, events subsequent to the initial investment proved the dangers facing the project. The continual renegotiation of the terms of the deal, including the 2000 suspension of the monthly payments due under the 1998 JAA and the reinvestment in 2003, substantiate the point.

322. The fact that Claimant was to receive a fixed minimum monthly payment does not undermine the finding that Claimant assumed substantial risk. Alpha’s monthly share of profits could have exceeded the monthly minimum, and the value of this potentially higher amount was inherently uncertain and risky. A reasonable investor would have had to assess how those potential payments under the JAAs compared to potential returns it could have earned if it had invested its funds elsewhere. The minimum monthly payments were, perhaps, designed to offset at least some of the risk involved. However, the fact that Claimant sought to protect itself against the demands of its bank borrowings does not mean that it had no investment or that the risks were eliminated.

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<sup>438</sup> Claimant’s Second Post-Hearing Submission, p. 5.

<sup>439</sup> See LECG report “Loss Assessment for Alpha Projektholding GmbH,” June 29, 1995, pp. 13-21.

<sup>440</sup> Luganova Affidavit, p. 8, para. 23 (in 1998, “Alpha was the only reputable entity that I could locate to invest in what was a state owned property”); Tsybuch Letter, p. 1 (“Over a long time ‘Alpha Projektholding’ GmbH was the only foreign investor who took an active part in development of hotel business in Ukraine at the time, when hotel business was in an extremely deplorable state because of the historical, political and economic situation in the Ukraine after the disintegration of the Soviet Union”).

323. Furthermore, Respondent’s argument would have the result of effectively removing a significant category of investments from protection. Many contracts, including typical loan agreements, have fixed payment terms. Indeed, as explained above, loan agreements can be a form of investment. The fact that a party is owed a fixed amount by the terms of a contract does not mean that all risk for that party has been eliminated, as the risk of default may remain at elevated levels. Removing all fixed payment contracts from the scope of investment protection would lead to a substantial loophole in the ICSID Convention, and Respondent has provided no convincing evidence that this was the intent of the drafters.

324. In short, the Tribunal concludes that there was risk involved in the commercial activity in which Claimant was engaged.

**c. Whether Claimant Made a Contribution or Commitment**

325. Claimant cited *Malaysian Salvors* for the proposition that one of the “hallmarks” of an investment<sup>441</sup> is the existence of “substantial commitments and outlays by the claimant.”<sup>442</sup> Claimant relies on the decision in *Tokios v. Ukraine* to help define the type of “substantial commitments and outlays” that qualify as an investment “contribution” for purposes of Article 25(1) of the ICSID Convention. In *Tokios*, the tribunal concluded that “[t]he investment would not have occurred but for the decision by Claimant to establish an enterprise in Ukraine and to dedicate to this enterprise financial resources under Claimant’s control. In doing so, Claimant caused the expenditure of money and effort from which it expected a return or profit in Ukraine.”<sup>443</sup>

326. Respondent does not rebut Claimant’s argument directly but instead points to other *Salini* criteria, alleging that Claimant’s payments took place outside Ukraine and were not of a sufficient duration.<sup>444</sup> The Tribunal has dealt with these objections elsewhere.

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<sup>441</sup> Reply, pp. 11-12.

<sup>442</sup> Claimant’s First Post-Hearing Submission, p. 3.

<sup>443</sup> *Tokios*, Jurisdiction at para. 78.

<sup>444</sup> Counter-Memorial, para. 142 and n.155.

327. As explained above, Claimant committed over USD 3.2 million towards the renovation of the Hotel in the expectation of receiving an economic return. The Tribunal is of the view that such expenditure falls within the scope of the term “contribution.”

**d. Whether the Alleged Investment Contributed to Ukraine’s Development**

328. Respondent argues that Alpha’s expenditures did not contribute to the economic development of Ukraine but rather “caused losses to the Hotel.”<sup>445</sup> Claimant, on the other hand, perceives “no real doubt” that Alpha’s expenditures were important to Ukraine because its activities were aimed at the “improvement, restoration, and redevelopment of what had once been the premiere hotel in Kiev.”<sup>446</sup> According to Claimant, the historic central square of Ukraine’s capital city needed “at least one grand hotel” in order to attract the siting of important events and to “lure” foreign businessmen and tourists, especially at a time when Ukraine was newly emerging as a market economy.<sup>447</sup>

329. In fact, the improved Hotel quickly became the site of many important official functions, and the Ukrainian Government even bestowed awards on the Hotel and the project during the period of operation.<sup>448</sup> According to Ms. Luganova, “in 1999 the Hotel was awarded a Distinction mark and a certificate of merit granted by the Cabinet of Ministers of the Ukraine ‘for significant contribution [in] the development of tourism in the Ukraine and high quality of service and implementation of new technologies.’ The Hotel’s reputation spread beyond Ukraine.”<sup>449</sup> The fact that the EBRD held its annual meeting at the Hotel in Kiev was apparently viewed in the local press as symbolic of Ukraine’s arrival on the European scene. Mr. Tsybuch, who was the head of the State Tourism Administration during all the formative years of the

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<sup>445</sup> Respondent’s Second Post-Hearing Submission, para. 12.

<sup>446</sup> Reply, p. 13.

<sup>447</sup> Reply, p. 13.

<sup>448</sup> See Kuess Affidavit, para. 33 (stating that the “joint activities received recognition in the form of various awards for the successful operation of the Hotel throughout the period of the parties’ cooperation”).

<sup>449</sup> Luganova Affidavit, para. 42.

renovation project, specifically wrote in his letter of March 16, 2009 that the Hotel “was of . . . vital importance for the state of Ukraine and for its capital Kiev.”<sup>450</sup>

330. Furthermore, according to Ms. Luganova, the renovations allowed the Hotel to increase sales, thereby leading to higher taxes owing by the Hotel and paid to the State.<sup>451</sup> According to Ms. Luganova, the Hotel’s income rose from USD 29.58 million in 1994-1998 to USD 32.9 million in 1999-2003.<sup>452</sup> Furthermore, “[i]ncome tax payments and payments to the State funds of SE Dnipro Hotel increased from \$10.89 million USD in the period from 1994 to 1998 to \$14.7 million USD in the period from 1999 to 2003.”<sup>453</sup> The Hotel’s profit of USD 7.7 million represented more than two-thirds of “the overall profit . . . generated by the approximately 100 other state owned hotels in Kiev during the same period.”<sup>454</sup>

331. The Tribunal concludes that Alpha’s participation in the joint activities for rehabilitating the Hotel contributed to the development of Ukraine and its economy.

**e. Conclusion as to Whether Claimant Has Made an “Investment” for Purposes of Article 25(1) of the ICSID Convention**

332. The Tribunal concludes that Claimant has made a protected “investment” under the terms of Article 25(1) of the ICSID Convention.

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<sup>450</sup> Tsybuch Letter, p. 1.

<sup>451</sup> Luganova Testimony, Tr. 2, p. 120, lines 9-22.

<sup>452</sup> See Luganova Affidavit, para. 38 (“In the period from 1994 to 1998, the overall income of SE Dnipro Hotel amounted to 29.58 million USD. In the period from 1999 to 2003, the overall income of SE Dnipro Hotel amounted to 34.94 million USD.”). During the hearing, Ms. Luganova corrected the second figure stated in her affidavit to USD 32.92 million. See Luganova Testimony, Tr. 2, p. 121, lines 11-13; Doc. C-189.

<sup>453</sup> Luganova Affidavit, para. 38.

<sup>454</sup> *Id.*; see also Docs. C-164 and C-165.

**E. Whether Claimant Is an “Investor”**

333. In order to establish jurisdiction under Article 9 of the UABIT, the Tribunal must find that there is a dispute between Ukraine and an “investor” of Austria. In relevant part, Article 1(2) of the UABIT defines the term “investor” as follows:

- (b) Any juridical person, company or commercial partnership constituted in accordance with the laws and regulations of either Contracting Party, having its seat in the territory of one Contracting Party and making an investment in the territory of the other Contracting Party;
- (c) Any juridical person or commercial partnership constituted in accordance with the laws and regulations of one Contracting Party or a third State and over which an investor referred to in subparagraphs (a) or (b) exercises decisive direct control.

334. Under Article 25(1) of the ICSID Convention, the Tribunal must determine that there is a dispute “between a Contracting State . . . and a national of another Contracting State.” Article 25(2)(b) defines the term “national of another Contracting State” as follows:

- (b) any juridical person which had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration and any juridical person which had the nationality of the Contracting State party to the dispute on that date and which, because of foreign control, the parties have agreed should be treated as a national of another Contracting State for the purposes of this Convention.

335. Claimant has submitted uncontroverted evidence of Alpha’s establishment and standing in Austria.<sup>455</sup> Respondent does not dispute that Alpha is an Austrian limited liability company with its registered place of business in Villach, Austria, or that Alpha was an Austrian company at the time the parties’ consent to arbitration was perfected. The Tribunal finds that these facts are sufficient to prove that Claimant is an Austrian juridical person – and, therefore, an Austrian investor – for purposes of the UABIT and the ICSID Convention.

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<sup>455</sup> Doc. C-187.

336. Respondent nevertheless questions Claimant’s right to have its claims heard by this Tribunal due to the “Ukrainian significant interest and influence” over Alpha stemming from Mr. Nichiporenko’s fifty percent shareholding in the Cyprus company, Konitch.<sup>456</sup> Respondent appears to frame its objections in terms of admissibility rather than jurisdiction.<sup>457</sup>

337. As previously explained, Konitch is a Cypriot limited liability company that held a 50% interest in Alpha for a number of years. During this period, Konitch’s holding in Claimant was larger than that of either Alpha Baumanagement or Ecco,<sup>458</sup> which were “affiliated” through Mr. Kuess.<sup>459</sup> Konitch was owned in equal shares by Mr. Piotr Kovalenko and Mr. Alexander Nichiporenko, both of whom were Ukrainian nationals.<sup>460</sup>

338. Respondent does not appear concerned with Piotr Kovalenko’s ownership interest, which Respondent believes simply satisfied a Cypriot Companies Law requirement to have a minimum of two shareholders.<sup>461</sup> Respondent argues that Piotr Kovalenko’s interest was “nominal” and that the “real ultimate beneficial interest” of Konitch’s holding in Alpha was held by Mr. Nichiporenko.<sup>462</sup> Respondent argues that Mr. Nichiporenko’s 50% shareholding in Konitch raises an issue of “substantive inadmissibility.”<sup>463</sup>

339. Respondent concludes that the Hotel renovation project was “knowingly structured” so as to allow the “top manager of Claimant’s contracting party” to obtain the “ultimate benefits” from Alpha’s investments in the Hotel.<sup>464</sup> Respondent cites Mr. Nichiporenko’s “obvious” resulting interest in the Hotel’s “transactions” with Alpha and Pakova.<sup>465</sup> Respondent contends that when an Austrian company such as Alpha “is significantly influenced by nationals” of Ukraine such as

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<sup>456</sup> Rejoinder, para. 45.

<sup>457</sup> *See, e.g., id.* at para. 43 (stating that “[w]ith respect to the substantive admissibility related to the nationality of (interest in) claim, the following can be observed ...”).

<sup>458</sup> Rejoinder, Supplement 1, para. 13.

<sup>459</sup> Kuess Affidavit, paras. 1, 6.

<sup>460</sup> Doc. R-49.

<sup>461</sup> Rejoinder, Supplement 1, para. 5.

<sup>462</sup> *Id.* at para. 6.

<sup>463</sup> Counter-Memorial, para. 144; Rejoinder, para. 43.

<sup>464</sup> Respondent’s First Post-Hearing Submission, para. 179.

<sup>465</sup> Counter-Memorial, para. 148.

Mr. Nichiporenko, then Ukraine finds itself protecting supposed foreign investors that “actually bring it no economic benefit.”<sup>466</sup>

340. At the Hearing, Counsel for Respondent reiterated that Claimant’s claims should not be admitted as a “matter of principle and common sense, as well as of integrity and security of international investment arbitration.”<sup>467</sup> Respondent asks the Tribunal to adopt a “realistic approach rather than a formalistic one”<sup>468</sup> by finding that the alleged investments by an entity that is Austrian in character but subject to Ukrainian influence are not protected by the UABIT.<sup>469</sup>

341. Claimant asserts that the “Respondent’s suggestion that Konitch’s status during the 1990’s as an Alpha shareholder somehow taints Alpha’s ‘foreign’ status is contrary not only to the express provisions of FIL and BIT but also to settled precedent.”<sup>470</sup> Claimant notes that Respondent had made “the identical objection” in “at least” two previous ICSID cases and had been “rebuffed” in both.<sup>471</sup>

342. For example, the *Tokios* tribunal concluded that the claimant in that case was “a Lithuanian corporation and that it was irrelevant that “99% of the outstanding shares of [the claimant corporation] were owned by Ukrainian nationals at the time of the ICSID proceeding and that Ukrainian citizens comprised two-thirds of its management . . . .”<sup>472</sup> The *Tokios* tribunal emphasized that Ukraine and Lithuania were perfectly capable, if they had chosen to do so, to exclude from their BIT “entities of the other party that are controlled by nationals of third countries or by nationals of the host country.”<sup>473</sup> But there, as here, there is no such “denial of benefits” provision. The *Tokios* tribunal saw the State Parties’ “deliberate choice” as meaning that it was beyond its purview “to impose limits on the scope of BITs not found in the text.”<sup>474</sup>

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<sup>466</sup> *Id.* at para. 146.

<sup>467</sup> Tr. 1, p. 53, lines 6-25; p. 54, lines 1-9.

<sup>468</sup> Counter-Memorial, para. 147.

<sup>469</sup> See Respondent’s First Post-Hearing Submission, para. 179.

<sup>470</sup> Reply, p. 8.

<sup>471</sup> *Id.* at p. 10.

<sup>472</sup> *Id.* at p. 8.

<sup>473</sup> *Tokios*, Jurisdiction at para. 36.

<sup>474</sup> *Id.* at para. 36.

Claimant believes that the arguments in favor of taking jurisdiction in the instant case are even clearer than in *Tokios* because there is no allegation of effective control over Alpha by Ukrainian nationals.

343. The Tribunal rejects Respondent's objection, whether it is framed as an objection to jurisdiction or to admissibility. Respondent concedes that Alpha is an Austrian company, and does not deny that Mr. Kuess has at all times been a citizen of Austria or that he has at all relevant periods directly controlled Alpha Baumanagement and Ecco Versicherungsmakler, two other duly organized Austrian limited liability companies<sup>475</sup> that have at all relevant times held an interest in Claimant. Respondent also has not contested Mr. Kuess' testimony that neither Konitch nor Mr. Nichiporenko exercised "decisive direct control" over Alpha. In fact, Konitch was no longer a shareholder in Alpha at the time the dispute arose or at the time the request for arbitration was submitted.<sup>476</sup> Furthermore, Respondent did not introduce any evidence of misappropriation of funds by Mr. Nichiporenko through his holding in Konitch and has not lodged any direct accusations in that regard.

344. The Tribunal notes that the initial ownership structure of Alpha – which included an indirect interest of Mr. Nichiporenko, who was at the same time the Director of the Hotel – creates an apparent conflict of interest. However, the ownership structure that then existed does not affect the fact that Claimant was an Austrian company at that moment as well as when it submitted the dispute to arbitration.

345. Respondent bears the burden of proof that Austria's and Ukraine's consent to arbitration in the UABIT was, in the words of *Tokios*, "clearly . . . not intended"<sup>477</sup> for the purpose of encompassing an Austrian entity such as Alpha. Respondent has not borne that burden and has not succeeded in building a convincing case that there is a valid basis for disregarding the bright-line tests of nationality jurisdiction as established by both the UABIT and the ICSID Convention. Respondent cannot avoid the consequences of that test by advancing as an admissibility

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<sup>475</sup> Doc. C-187.

<sup>476</sup> See Doc. C-200.

<sup>477</sup> *Tokios*, Jurisdiction at para. 39.



objection what is, at its foundation, a jurisdictional challenge. Respondent's objection is therefore dismissed.

## **VII. Merits**

### **A. Applicable Law**

346. As discussed in section V.B above, Article 42(1) of the ICSID Convention provides: "(1) The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute . . . and such rules of international law as may be applicable."

347. Claimant alleges that Ukraine violated various provisions of the UABIT as well as the FIL. As discussed above, the Tribunal has concluded that it has jurisdiction under both sets of claims. In addressing the merits of the claims under the UABIT, the Tribunal shall in the first instance apply the substantive provisions of the UABIT. Where necessary to resolve factual questions, including the scope of Claimant's rights and interests in the JAAs, the Tribunal shall apply the domestic law of Ukraine.

348. The Tribunal shall examine the merits of Claimant's claims for violations of the FIL by applying the FIL and, more generally, Ukrainian law. In conducting this analysis, the Tribunal will be mindful of the fact that Article 6 of the FIL states that "[i]f an international agreement of Ukraine, provides rules other than that provided for by the legislation of Ukraine, the rules of the international agreement shall apply."

### **B. Relevant Government Acts**

349. Claimant primarily relies on two events to support its claims that Ukraine has breached its obligations under the UABIT and the FIL. The first is the corporatization process and related events, including the preparation of the GEYA Appraisal . The second is the cessation of payments in June 2004. The Tribunal will first address the general impact of these events on

Claimant's rights under the JAAs, and will then proceed with an examination of their implications under the UABIT and the FIL.

### **1. Effect of Corporatization**

350. The parties spent considerable time debating the impact of the corporatization process on Claimant's rights under the joint activity agreements. In addition to the GEYA Appraisal, Claimant and its legal expert, Professor Omelchenko, focused on three actions related to the corporatization:<sup>478</sup> (1) Order No. 103 of August 13, 2003 of the State Tourism Administration approving the "corporatization," the Act of Appraisal and the Charter for the new OJSC Hotel;<sup>479</sup> (2) the registration of the new Hotel Charter with a capitalization that was derived from the Acquisition Balance Sheet;<sup>480</sup> and (3) Order No. 120 of September 30, 2003, of the State Tourism Administration.<sup>481</sup> In summary, Claimant asserts that the Appraisal failed to take account of Claimant's full ownership interests in the joint activities and, by giving the results of the Appraisal official state recognition through the aforementioned acts, Ukraine extinguished those interests.

351. In assessing the impact of the consequences of the various acts Claimant references, it is important to recall the different ownership interests that Claimant contends are present in a legitimate joint activity. According to Claimant, these interests include (1) a right to a share of the profits during the life of the joint activity; (2) upon termination of the joint activity, a right to the return of each party's original contribution; and (3) a right to a share of the value of the assets of the joint activity. According to Professor Omelchenko, these interests are codified in Ukrainian law,<sup>482</sup> and the first and third of these interests are also codified in the underlying contracts. As discussed below, both parties agree that the parties' rights under Ukrainian law

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<sup>478</sup> Claimant's Second Post-Hearing Submission, p. 11.

<sup>479</sup> Doc. C-30 and Omelchenko Testimony, Tr. 5, p. 24, lines 7-10.

<sup>480</sup> See Docs. C-155 and 156. Claimant's Second Post-Hearing Submission, p. 11.

<sup>481</sup> Doc. C-31 and Claimant's Second Post-Hearing Submission, p. 12.

<sup>482</sup> Omelchenko Opinion, p. 9, para. 2.5; Omelchenko Testimony, Tr. 4, p. 145, lines 18-24; p. 147, lines 7-12. As noted, Mr. Maydanyk appeared to agree with this general description of a joint activity, at least with respect to the division of profits and, upon termination of the joint activity, to the division of the joint property. Maydanyk Testimony, Tr. 5, p. 171, lines 3-6 (referring to division of profits *pro rata* to the parties' "shares"); pp. 174-175 (discussing distribution of joint property upon termination of the joint activity).

and under the contracts are separately enforceable rights, although the Ukrainian law on joint activities would prevail in the event of a conflict.

352. The parties' argumentation focused on the impact of the corporatization on Claimant's right to receive monthly payments and its right to a share of the assets of the joint activity. The Tribunal shall deal with these issues independently. Claimant did not provide a separate analysis of the impact of the corporatization on any right to the return of its original contribution.

#### **a. Right to Receive Monthly Payments**

353. As explained in the fact section above, in calculating the revenue figures under the 1998 JAA for purposes of its Appraisal, GEYA assumed a 50/50 split of the forecast profits through 2007 between Claimant and the Hotel, and a minimum monthly payment of USD 35,000 to Claimant from 2007 onward. With respect to the 1999 JAA, the Appraisal reflected a minimum monthly payment to Claimant of USD 35,000. Both parties agree that the contracts specified that Claimant was to receive a minimum monthly payment of USD 50,000 under each contract. There is, therefore, a clear discrepancy between the Appraisal and the terms of the contracts.

354. The Tribunal can discern no practical impact from the Appraisal or the corporatization process on Claimant's right to receive monthly payments in the amount specified in the contracts. Both Claimant and Respondent agree that the Appraisal and related approvals did not change the terms of the underlying contracts. According to Respondent, whether correct or not, the inclusion of a USD 35,000 monthly payment rather than a USD 50,000 monthly payment in the Appraisal "in no way affected the right of Alpha to receive its profits in accordance with the JAAs in the full amount."<sup>483</sup> Claimant's expert Professor Omelchenko also confirmed that the corporatization did not alter the rights and obligations of the parties under the joint activity agreements.<sup>484</sup> He subsequently stated that "even if property rights were infringed in the process

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<sup>483</sup> Respondent's First Post-Hearing Submission, p. 87, para. 235.

<sup>484</sup> Omelchenko Testimony, Tr. 5, p. 20, lines 18-25 and p. 21, lines 1-5.

of corporatization, the hotel could and was obligated to carry out the terms and conditions of the joint activity agreement.”<sup>485</sup>

355. The Tribunal also notes that the Hotel continued to make monthly payments of USD 50,000 under the 1999 JAA to Claimant until June 2004, long after the corporatization process concluded.<sup>486</sup> In addition, the agreement to extend the 1999 JAA – including the obligation to pay Claimant a minimum of USD 50,000 per month – was agreed in the middle of the corporatization process, on August 29, 2003. Similarly, the Additional Agreement to the 1998 JAA signed on November 19, 2003, regarding the “reinvestment” under the 1998 JAA, stated that the Additional Agreement does not change the allocation of profit agreed in the amended 1998 JAA, which implies that the parties recognized the obligation to make the contractually agreed monthly payments.<sup>487</sup> These agreements are inconsistent with the view that the corporatization process extinguished Claimant’s right to a minimum monthly payment.

356. The Tribunal concludes that the corporatization process did not, in itself, extinguish or otherwise affect Claimant’s right to receive the minimum monthly payments or its 50% share of profits, as the case may be, under the JAAs.<sup>488</sup>

#### **b. Claimant’s Right to a Share of the Assets of the Joint Activities**

357. With respect to the effect of the corporatization on Claimant’s share of the assets of the joint activities, the crux of the parties’ disagreement is whether, in fact, Claimant ever possessed an interest in the fixed improvements to the Hotel made over the terms of the joint activities. Claimant asserts that it was entitled to such an interest and that, by failing to reflect its worth in the Appraisal and corporatization process, Respondent extinguished that interest.

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<sup>485</sup> Omelchenko Testimony, Tr. 5, p. 31, lines 1-4.

<sup>486</sup> See Doc. C-203.

<sup>487</sup> Doc. C-161.

<sup>488</sup> As explained in section VIII, however, the Tribunal has also concluded for other reasons that the terms of the JAAs must be amended as of January 1, 2004.

358. Professor Omelchenko expounded at length on Claimant’s alleged ownership interest in the improvements. He asserted that the “going concern established in the course of the joint undertaking is to be divided in equal parts upon termination of the contractual joint venture.”<sup>489</sup> Consequently, he concluded, Alpha became a “co-owner of all assets contributed to and resulting from the joint undertaking. By participation in the joint undertakings, Alpha acquired rights *in rem*.”<sup>490</sup> He expressed the view that upon the “expiration of the term of both agreements (30 June 2015), Alpha is entitled to receive 50% of the value of the joint undertaking, appraised as a going concern.”<sup>491</sup> He posited that, at the “conclusion of the joint activities, ownership of the improvements goes to the Hotel,” but the Hotel “must pay Alpha 50% of the then value of the improvements.”<sup>492</sup> He stated the view that the improvements to the Hotel “have been done only thanks to Alpha’s investment. According to Article 1134 . . . , the contributions, the results and the improvements which resulted from the activity . . . are the joint property of parties of the agreement . . . What I say in my opinion is that Alpha has a part (*sic*) of property in the improvements and in the equipment[.]”<sup>493</sup>

359. In contrast, Respondent asserted that Claimant never possessed such an interest before or after the corporatization and, therefore, the corporatization could not have affected any property right of the Claimant. For example, Respondent’s legal expert, Professor Maydanyk, argued that, under the 1998 and 1999 JAAs, “no right of joint ownership to the improvements of the rooms has emerged, as such improvements have not been transferred as a contribution of Pakova to the joint activity.”<sup>494</sup>

360. The Tribunal concludes that the Appraisal did, in fact, include the entire value of the Hotel’s fixed assets, including the improvements made during the term of the joint activities, and that the Appraisal did not allocate any such value to the joint activities or to Claimant. However, for the reasons explained below, the Tribunal also concludes that Claimant has not carried its

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<sup>489</sup> Omelchenko Opinion, para. 2.3.

<sup>490</sup> *Id.* at para. 2.4.

<sup>491</sup> *Id.* at p. 9, para. 2.7.

<sup>492</sup> *Id.* at p. 11, para. 3.4.

<sup>493</sup> Omelchenko Testimony, Tr. 5, p. 42, lines 8-25.

<sup>494</sup> Doc. C-224, p. 14, para. 2.3.

burden in proving that the decision to include the value of the improvements in the appraised value of the Hotel was improper or affected Claimant's rights.

361. With respect to the question of whether the Appraisal allocated the value of the improvements to the Hotel, the Tribunal notes, for example, that when valuing the building based on net income potential, GEYA included the enhanced value of the rooms due to the improvements, without any indication that Claimant may have had an ownership share in the improvements.<sup>495</sup> Ms. Trusova herself testified during the hearing that “[a]s far as building of the hotel is concerned, this building included the construction works which has been done during the joint activity.”<sup>496</sup> Respondent never clearly denied that the Appraisal allocated the full value of the improvements to the Hotel. Indeed, Respondent's argument that the Hotel had full ownership rights over the improvements is fully consistent with the conclusion that the Appraisal included the improvements as a whole in the Hotel's value.

362. In examining the propriety of GEYA's approach, the Tribunal will deal with the 1998 and 1999 JAAs separately, starting with the 1999 JAA. Article 2 of the 1999 JAA states that the Hotel contributed the right to use the floors, Claimant contributed approximately USD 1.7 million, and Pakova contributed “the works performed by him on reconstruction (repairs) and equipping the Hotel's rooms on the 8-10<sup>th</sup> floors, estimated to the sum of” approximately USD 1.7 million. Thus, the improvements to floors 8-10 originally constituted Pakova's contribution to the joint activity. As explained above, Pakova withdrew from the 1999 JAA a little over a month after it was concluded.

363. The parties to the 1999 JAA contemplated Pakova's withdrawal from the outset. Article 4.3 of the 1999 JAA states that, upon its withdrawal, Pakova “undertakes to leave the improvements of rooms on the 8-10<sup>th</sup> floor performed by him, on the balance of the joint activities for the compensation equal to his contribution into the joint activities. After the termination of the present Contract the above improvements are to be returned to the Hotel as the part of rooms on 8-10<sup>th</sup> floors.” Thus, while the ownership rights over the improvements were to

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<sup>495</sup> GEYA Appraisal, Doc. C-149, p. 30.

<sup>496</sup> Trusova Testimony, Tr. 3, p. 169, lines 2-4.

revert to the joint activity for the life of the JAA, the Hotel alone would take ownership of the assets upon termination of the joint activity. This arrangement was further confirmed in Additional Agreement No. 1 to the 1999 JAA, which formalized Pakova's withdrawal. Article 4.5 of that Agreement confirmed that the improvements were to be "given back to the Hotel" upon termination of the joint activity.

364. Article 4.3 of the 1999 JAA and Article 4.5 of Additional Agreement No. 1 make it clear that Claimant would have no ownership rights whatsoever in the improvements after the termination of the joint activity. Furthermore, any interest Claimant might have during the term of the joint activity appears no more than theoretical as Claimant has not demonstrated how such interest would affect the monthly payments, profit share, or any other economic interest to which Claimant might be entitled. Whether the corporatization did or did not extinguish this theoretical interest during the terms of the JAAs is irrelevant, as the interest has no economic value discernible from the record. Furthermore, the Tribunal cannot accept Professor Omelchenko's assertion that, even if ownership of the improvements reverts to the Hotel, Claimant is entitled to half of the value of the improvements. Upon termination of the joint activity, the improvements are no longer jointly owned, and Claimant has no interest in them.

365. The issue under the 1998 JAA is less clear. Respondent's expert, Professor Maydanyk argued that Claimant could have no ownership interest in the improvements because such ownership could only result from the alienation of State property. According to Professor Maydanyk, alienation of State property is impermissible without obtaining proper authorization, and no such authorization was obtained in this case.<sup>497</sup> He further asserted that the improvements are inextricably linked to the building, and the Hotel's ownership of the building conferred on it ownership of the improvements.<sup>498</sup>

366. However, even assuming Professor Maydanyk has properly characterized Ukrainian law on this point, the Tribunal questions its applicability to the case at hand. Professor Maydanyk assumed that the assets belonged to the State, and that any ownership right by Claimant could

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<sup>497</sup> Maydanyk Supplemental Opinion, pp. 5-6.

<sup>498</sup> *Id.* at p. 6.

only result from alienation of that property. Claimant asserted that the State only ever possessed a 50% interest in the assets. If so, then the State would not be alienating the other 50% because it never owned that share of the property in the first place. Professor Maydanyk’s argument that the improvements automatically revert to the Hotel is plausible but not compelling.

367. Regardless of how the matter should be resolved under Ukrainian law, and assuming for the sake of argument that Claimant had some form of ownership interest in the improvements under the 1998 JAA, the Tribunal concludes that Claimant has not carried its burden of proof in demonstrating that the corporatization process in and of itself extinguished any such interest.

368. Claimant contended that the Act of Appraisal of July 23, 2003, as officially approved by the State Tourism Administration,<sup>499</sup> “served as the basis for calculation of the charter capital” for the OJSC Hotel.<sup>500</sup> According to Claimant, by adopting the “closing figures” as of April 30, 2003, as contained in the Hotel’s Acquisition Balance Sheet (and as derived from the GEYA Appraisal), the Act of Appraisal “deliberately” extinguished the Hotel’s long-term liabilities to Alpha under the JAAs.<sup>501</sup> Claimant charged that, by including the “entirety of the Hotel’s physical plant” as an asset owned by the Hotel, the corporatization process “arrogated” ownership of Alpha’s property interests to the State<sup>502</sup> and “eradicate[ed]” Claimant’s investment in the joint activities.<sup>503</sup>

369. Respondent argued that even if there were a “mistake” in the Appraisal (which Respondent denied), it would only affect the “value of the appraised asset” and the “nominal amount of the statutory fund” of the OJSC Hotel.<sup>504</sup> Respondent’s expert, Professor Maydanyk, argued that an act of appraisal has no “binding” effect,<sup>505</sup> and that an accounting document is not a “title document” and does not have any effect upon the “ownership of assets.”<sup>506</sup> In any case, Respondent argued, the two Orders underlying the corporatization referenced in paragraph 349

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<sup>499</sup> Doc. C-152.

<sup>500</sup> Claimant’s First Post-Hearing Submission, p. 21.

<sup>501</sup> *Id.*

<sup>502</sup> *Id.*

<sup>503</sup> *Id.* at p. 22.

<sup>504</sup> Respondent’s First Post-Hearing Submission, p. 71, para. 185; p. 70, para. 182; Doc. C-34.

<sup>505</sup> Supplemental Expert Opinion of Roman Maydanyk, p. 3.

<sup>506</sup> *Id.* at p. 4.



above “took nothing” from the GEYA report “except for the total figure reflecting the value of the fixed assets of the company.”<sup>507</sup>

370. The Tribunal notes that the two Orders on which Claimant relies do not provide more than a general description of the assets that are deemed to belong to the Hotel. The assets that are listed are described at a very general level, *e.g.*, the descriptor “Hotel building” is used in the Annex to Order No. 120 without any further elaboration on the values of the individual floors or the improvements. While the Orders incorporate GEYA’s final assessed value, with some adjustments, this is far different than ordering a specific transfer of assets from one entity to another. In the Tribunal’s view, the number appears to be used for accounting and capitalization purposes rather than as an assertion of title. As such, the Tribunal concludes that the corporatization process did not in itself establish any right of ownership over the value of the improvements under either the 1998 or the 1999 JAA.

371. The Tribunal emphasizes that, even though it concludes that the corporatization process did not in itself result in extinguishing any of Claimant’s rights, the behavior exhibited by the State during the corporatization process may nevertheless be relevant in establishing a broader pattern of behavior that may evidence a breach of the UABIT and the FIL, as discussed below.

## **2. Stop in Payments**

372. The second critical event giving rise to the present dispute is the stop in payments in June 2004. Both parties agree that Claimant received its last payment in June 2004. However, they disagree as to whether the order to cease payments originated with Ukrainian authorities or whether it was a decision taken by Hotel management alone. For the reasons explained below, the Tribunal concludes that Ukrainian authorities caused the stop in payments.

373. The Tribunal recognizes that there is no clear documentary trail, no “smoking gun,” demonstrating directly that Ukraine ordered the stop in payments. The Tribunal was not, for example, presented with any minutes of meetings of the Supervisory Board recording any such

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<sup>507</sup> Respondent’s First Post-Hearing Submission, p. 86, para. 234.

instruction. The Tribunal was informed, however, that there is no internal Ukrainian regulation requiring the recording of decisions by such bodies.<sup>508</sup> The Tribunal finds that there is sufficient evidence to conclude that the State ordered the cessation of payments to the Hotel. The Tribunal recalls in this regard the reasoning adopted by the tribunal in *Tokios* that it “must in practice form an idea, necessarily based on secondary and circumstantial evidence since direct evidence is out of reach, not so much about the identity of the prime mover but whether it was a person or group of persons whose actions were, for the purposes of the treaty, those of the State.”<sup>509</sup> Here, the Tribunal has formed such an idea, and that is that the course of conduct beginning with the corporatization of the Hotel demonstrates the State’s direct involvement in the management of the Hotel and its desire to terminate the relationship with Claimant.

374. Starting with the corporatization process in 2003, the State evidenced its disenchantment with the arrangements between Claimant and the Hotel. As the Tribunal has already concluded, Ms. Timoschik from the State Property Fund was complicit in the decision to ignore the payment terms specified in the contract when preparing the GEYA Appraisal. The Tribunal recognizes that the State may have had good reason to object to the minimum monthly payment terms even though the State-owned Hotel was contractually committed to them. However, it was improper for State authorities to unilaterally determine that the terms of the JAAs were unfair, with no consultation or engagement with Claimant, and then direct that an appraisal be conducted on the basis of that determination, particularly given that both the 1998 and the 1999 JAAs include procedures for arbitrating disputes under the agreements or amending the terms of the agreements.<sup>510</sup> That it was the State, and not the Hotel, that was opposed to the terms of the contracts is clear from the fact that, in the midst of the corporatization process or soon thereafter, the Hotel signed the Additional Agreement extending the term of the 1999 JAA and the Additional Agreement regarding the reinvestment of funds under the 1998 JAA, both of which explicitly or implicitly reaffirmed the obligation to make minimum monthly payments to Claimant of USD 50,000 per month.<sup>511</sup> Even if the corporatization process did not affect the

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<sup>508</sup> Respondent’s First Post-Hearing Submission, para. 105.

<sup>509</sup> *Tokios*, Award, paras. 13-14.

<sup>510</sup> See C-127, Art. 8; C-132, Art. 8.

<sup>511</sup> Further as noted, in the 2000-2001 time frame, the Hotel management and the Claimant discussed the possibility of working together to refurbish floors 4-7 of the Hotel, indicating that they continued to have a good working relationship after the signing of the 1998 and 1999 JAAs.

parties' rights and obligations under the JAAs, the handling of the appraisal shows a disregard for proper procedures and demonstrates a difference in view as between the State and Hotel management regarding the propriety of the terms of contracts that State authorities had previously either expressly or impliedly approved.

375. The State authorities' opposition to the arrangements was also demonstrated by the fact that, upon taking ownership of the Hotel, the State Administration of Affairs (SAA) arranged for the Hotel to be raided in April 2004 by the State Main Control and Revision Office (MCRO). During the raid, all the documentation related to the financial activities of the Hotel, including with respect to the joint activities, was seized. In addition, a criminal investigation into the activities of Hotel officials was commenced, including with respect to the prolongation of the term of the 1999 JAAs to 2015 and with respect to the payments to Pakova.<sup>512</sup>

376. In May 2004, the MCRO issued a report on the Hotel in connection with the work of a broader commission reviewing the arrangements between Claimant and the Hotel. According to Mr. Melnikov, who was an employee of the SAA and a member of the commission,<sup>513</sup> this report was a standard part of the process related to the transfer of shares to the SAA.<sup>514</sup> As part of the report, representatives from the MCRO issued a certificate finding that payments under the 1999 JAA to Pakova violated the FIL.<sup>515</sup> The audit also alleged excessive payments to Alpha by the Hotel.<sup>516</sup>

377. The Tribunal recognizes that Ukraine may have had reason to seek a readjustment of the contracts despite the fact that it was not a party to them. As the Tribunal will discuss, the contractual terms between the Hotel and Alpha appear unbalanced in many respects and the minimum monthly payments were not sustainable in light of the background statutory rules on the operation of joint activities, as discussed in further detail below. However, subsequent events demonstrated that the State's handling of the corporatization, its investigations into the Hotel's activities, and the passing of ownership of the Hotel to the SAA, were not based simply

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<sup>512</sup> Luganova Affidavit, para. 45 and Affidavit of Mr. Volodymyr Melnikov, pp. 1-2 ("Melnikov Affidavit").

<sup>513</sup> Melnikov Testimony, Tr. 4, p. 53, lines 4-6.

<sup>514</sup> *Id.* at p. 49, lines 6-11.

<sup>515</sup> Doc. C-190, pp. 8-9.

<sup>516</sup> *Id.* at pp. 12, 16.

on the interest of the State as owner in the propriety of the Hotel's affairs. Instead, they resulted in the State asserting greater control over the Hotel and put the SAA and potentially other State agencies in a position to short-circuit proper procedures in terminating the contracts or to subvert the contracts.

378. The circumstances of the transfer of ownership to the SAA, and the immediate aftermath of that transfer, are particularly troubling. As early as December 27, 2002, the Head of the SAA wrote to the Prime Minister of Ukraine requesting the transfer of the Hotel into its management “in the interests of the State and the working collective.”<sup>517</sup> A little over a year later, the President of Ukraine Leonid Kuchma instructed the Cabinet of Ministers to transfer the Hotel from the management of the State Tourism Administration to the management of the SAA.<sup>518</sup> The Cabinet of Ministers implemented the Presidential Order through Decree No. 196 of March 31, 2004.<sup>519</sup> Decree No. 196 was originally “off the record” and “not for promulgation” (*i.e.*, not subject to publication), a restriction that was lifted pursuant to Resolution No. 490 of the Cabinet of Ministers of March 19, 2008.<sup>520</sup>

379. The SAA was a peculiar choice for owning and operating the Hotel. The SAA is “subordinated” to the President of Ukraine and is tasked with servicing the needs of the President, the Parliament, the Cabinet and other State bodies. It does not appear designed or equipped to oversee or operate a commercial hotel establishment.<sup>521</sup>

380. Indeed, upon taking ownership of the Hotel, the SAA sought to strengthen the formal role of the State in the management of the Hotel. The SAA approved a new Charter on May 27, 2004, which was then amended on September 28, 2004. Mr. Melnikov confirmed that the SAA was behind the changes to the Charter.<sup>522</sup> Section 8 of the new Charter increased the size of the Supervisory Board from five to seven members by adding two seats for SAA representatives. Under this new composition, one SAA representative would be designated as the “Head” of the Supervisory Board. This representative, plus the two new members and the representative from

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<sup>517</sup> Doc. C-146.

<sup>518</sup> Doc. C-32.

<sup>519</sup> Doc. C-51 and Request, p. 6, para. 17.

<sup>520</sup> Doc. C-35.

<sup>521</sup> Doc. C-24, paras. 1, 3.

<sup>522</sup> Melnikov Testimony, Tr. 4, p. 33, lines 6-8.

the State Property Fund, would comprise four of the seven members of the reconstituted Supervisory Board.<sup>523</sup> From approximately June to September 2004, Mr. Melnikov worked for the SAA and was a member of the Supervisory Board.<sup>524</sup>

381. According to the Charter, “[t]he Supervisory Board is not entitled to interfere with operative actions of the Company Board of Directors.”<sup>525</sup> As under the previous Charter, the Board of Directors, not the Supervisory Board, was vested with authority to enter into contracts on behalf of the Hotel.<sup>526</sup> As the Tribunal will explain, the evidence indicates that these restrictions were not strictly adhered to.

382. In July, the membership of the Supervisory Board was expanded to eight members so as to include another government representative, this one from the Ministry of Economy of Ukraine.<sup>527</sup>

383. The SAA further consolidated its hold on the management of the Hotel when, in the beginning of June 2004,<sup>528</sup> it fired Ms. Luganova,<sup>529</sup> who had served as Director of the State-owned Enterprise Hotel from October 1998 to August 2003 and as Chairman of the Board of Directors of the OJSC Hotel from August 2003 to June 2004.<sup>530</sup>

384. On June 11, 2004, just days after the firing of Ms. Luganova and the issuance of the amended Charter, Alpha received its last payment under the 1999 JAA.<sup>531</sup> The Tribunal notes that the day-to-day management of the Hotel had not to this date expressed any intention to

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<sup>523</sup> Doc. C-169, p. 8, Art. 8.

<sup>524</sup> Melnikov Testimony, Tr. 4, p. 10, line 24; p. 12, lines 12-14.

<sup>525</sup> Doc. C-169, p. 9, Art. 8.

<sup>526</sup> The May 2004 Charter states that the head of the Board of Directors is entitled to “carry on negotiations and enter into agreements on behalf of the company.” Doc. C-169, p. 10, Art. 8. The 2003 Charter stated that the Board of Directors was authorized to “enter[ ] into agreements (contracts) in accordance with applicable laws of Ukraine and requirements of the Charter of the Company” and “make[ ] decisions as to disposal of the Company property the cost of which does not exceed 50 percent of the authorized capital including in the event if (*sic*) participation of the Company in establishment of other business entities.” Doc. C-155, p. 10, Art. 8.

<sup>527</sup> Doc. R-80, p. 5.

<sup>528</sup> Claimant’s Second Post-Hearing Submission, p. 12.

<sup>529</sup> Melnikov Testimony, Tr. 4, p. 48, lines 7-11.

<sup>530</sup> Luganova Affidavit, para. 3.

<sup>531</sup> Isopp Affidavit, para. 6.

discontinue the relationship with Claimant. In fact, on June 29, 2004, the new Chairman of the Hotel, Mr. Grigorenko, wrote a letter to Mr. Kuess pledging continued “effective cooperation” with Alpha and affirming the “conditions of collaboration” between the Hotel and Alpha.<sup>532</sup>

385. The June payment was, in fact, several months late and covered the monthly payment due for January 2004. Alpha received no payment for February 2004 or any month thereafter. February was the same month that President Kuchma ordered that the Hotel be transferred to the SAA (though the transfer was not formalized until the end of March).

386. Respondent argued that the State at no point interfered in the day-to-day management of the Hotel, relying, for example, on provisions in the various Charters that purport to limit the State’s authority in that regard.<sup>533</sup> Mr. Melnikov repeatedly confirmed this view in his testimony.<sup>534</sup> In contrast, Ms. Luganova testified that, during her earlier tenure at the Hotel, she telephoned her “superiors” in State Ministries “almost every day and then met them every second day.”<sup>535</sup> She also testified that she did not believe, on the basis of her many years of experience at the Hotel, that internal management would have made a decision to cease the payments to Alpha on its own authority, without input from the Supervisory Board or State officials or without the “agreement of superior organs” of the Ukraine government.<sup>536</sup>

387. Neither Mr. Melnikov nor Ms. Luganova was at the Hotel at the time the payments ceased, and the Tribunal has not received testimony from Mr. Grigorenko. The Tribunal is thus faced with the question of how to reconcile Mr. Grigorenko’s June 29 letter with the fact that the Hotel shortly thereafter ceased making payments to Claimant. There is no indication that Mr. Grigorenko was intentionally misleading Claimant. The Tribunal notes that on or about July 1, 2004, the MCRO issued a second report again objecting to the payment to Pakova but not finding any wrongdoing with respect to Claimant.<sup>537</sup> However, given that a commission of

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<sup>532</sup> Doc. C-196 and Respondent’s Second Post-Hearing Submission, para. 24.

<sup>533</sup> See, e.g., Counter-Memorial, para. 324, n.369; Respondent’s Second Post-Hearing Submission, paras. 11-19.

<sup>534</sup> See, e.g., Melnikov Testimony, Tr. 4, pp. 82-84.

<sup>535</sup> Luganova Testimony, Tr. 2, p. 165, lines 18-25.

<sup>536</sup> Luganova Testimony, Tr. 2, p. 166, lines 24-25; p. 167, lines 1-12; p. 168, lines 10-14; p. 193, lines 15-24.

<sup>537</sup> Doc. C-194, p. 2; Respondent’s Second Post-Hearing Submission, pp. 9-10, paras. 33-34.

MCRO and SAA officials had already identified these and other problems months before, it is not clear why the July report would have led Mr. Grigorenko to have a change of heart.

388. The cessation of payments is much more easily reconciled with Ms. Luganova's testimony regarding the management of the Hotel. If, in fact, government officials played a central role in the day-to-day management of the Hotel regardless of the nominal restrictions in the Hotel Charter, and if, as the evidence indicates, the SAA was hostile to the previous management of the Hotel and the JAAs, and was seeking to consolidate its control over the Hotel, then the cessation of payments becomes more readily understandable.

389. Events after the cessation of payments confirm the State's continuing involvement in the decision not to pay Claimant. For example, on September 17, 2004, the SAA responded to an inquiry from the Embassy of Austria<sup>538</sup> by suggesting that future inquiries be directed to the Hotel; however, at the same time, it expressed the view that, in light of the review being undertaken by the prosecutor's office, "any settlement may now complicate execution of the legal authorities decisions, [and] such settlement will be done only upon making of appropriate decisions and within the terms specified by existing legislation of Ukraine. We will additionally notify you upon completion of review and resolution by the General Prosecutor's Office." The SAA thus drew a direct link between "settlement," which the Tribunal understands to mean resolution of the dispute over the monthly payments, and actions taken by the "legal authorities," and the SAA thereby positioned itself directly in the middle of that process. Similarly, on August 5, 2005, the SAA responded to a complaint about Alpha's treatment made by the Embassy of Austria to the Ukrainian Ministry of Foreign Affairs and asserted that any settlement at that time would complicate a review by the General Prosecutor's Office.<sup>539</sup>

390. In the meantime, in October 2004, only a few months after the transfer of ownership to the SAA, the President of Ukraine sought to privatize the Hotel and to transfer ownership to

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<sup>538</sup> Doc. C-168.

<sup>539</sup> Doc. C-177.

Dnipro Elite, an apparently criminal enterprise. In the same month, criminal proceedings commenced against the former management of the Hotel, including Ms. Luganova.<sup>540</sup>

391. According to Ms. Luganova, the Supervisory Board did not approve the transfer to Dnipro Elite,<sup>541</sup> as required under the Charter.<sup>542</sup> Furthermore, according to Ms. Luganova, a transfer of State-owned property to a private entity is “forbidden” under Ukrainian law due to the “ban” on privatization.<sup>543</sup> Indeed, the subsequent Presidential Administration of Viktor Yushchenko sought to cancel the “hidden privatization” of the Hotel that was carried out under Decree No. 655 of October 1, 2004.<sup>544</sup> On May 23, 2005, the Kiev Economic Court voided the attempted privatization.<sup>545</sup>

392. The Tribunal notes that it is not clear that the SAA was involved in the unlawful privatization of the Hotel. In fact, given that the Supervisory Board apparently did not approve the transfer, it is possible that the SAA was not involved. The Tribunal has already noted, however, that there was no regulation requiring transparency in the conduct of the affairs of the Supervisory Board. Furthermore, in the Tribunal’s view, the arbitrary and illegal privatization of the Hotel demonstrates the State’s flagrant disregard for proper procedures in handling matters related to the Hotel, and the State clearly helped perpetuate the Hotel’s failure to make payments to Claimant.

393. On March 6, 2005, the criminal investigation begun in April 2004 was closed on the basis that (a) Hotel officials, including Ms. Luganova, did not “breach the current legislation of Ukraine” and (b) there were “no facts of damage caused” to the interests of the State, despite the contrary findings resulting from the MCRO audits.<sup>546</sup> However, despite these findings, the Hotel did not resume payments to Claimant.

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<sup>540</sup> Doc. C-173: Melnikov Testimony, Tr. 4, p. 62, lines 9-24; Melnikov Affidavit, pp. 1-2.

<sup>541</sup> Luganova Testimony, Tr. 2, p. 110, lines 18-24.

<sup>542</sup> The Charter in effect at the time states that the Supervisory Board is responsible for “coordinat[ing] operations of Company real estate disposal.” Doc. C-169, p. 8, Art. 8.

<sup>543</sup> Luganova Testimony, Tr. 2, p. 110, lines 18-25; p. 111, lines 1-10; p. 112, lines 8-17.

<sup>544</sup> Doc. C-172.

<sup>545</sup> Doc. R-31.

<sup>546</sup> Doc. C-175, p. 2.



394. Also in March 2005, the Office of President Yushchenko asked Ms. Luganova to return as the Chairman of the Board of Directors of the Hotel<sup>547</sup> and to carry out an audit.<sup>548</sup> According to Ms. Luganova, she was asked by the Deputy Minister of the Interior of Ukraine “to prepare proposals” to bring about the cancellation of the transfer of share ownership in the Hotel from the State Tourism Administration to the SAA.<sup>549</sup> Following completion of the audit, Ms. Luganova (a) informed the Minister of Interior that Dnipro Elite had “misappropriated” the assets of the JAAs and (b), on behalf of the Hotel, filed suit against the SAA.<sup>550</sup> Shortly thereafter, in April 2005, Ms. Luganova was again removed as Chairman of the Board of the Hotel for reasons that the record does not illuminate.<sup>551</sup> That same month, Mr. Melnikov, who reiterated his long opposition to the joint activities during the course of the arbitration, resigned from the SAA and assumed a senior position at the Hotel.<sup>552</sup> The Hotel continued to refuse to make payments to Claimant.

395. The law enforcement authorities also continued their investigation into the Hotel’s former management despite initially concluding that there had been no wrongdoing. According to Mr. Melnikov, the case “has been closed several times, then the supervisory office in the General Prosecutor’s Office decided to re-open it and continue the investigation, so the case is still pending.”<sup>553</sup> The Tribunal finds the on-again-off-again investigation by the Prosecutor’s Office disturbing. In this regard, the Tribunal recalls the statement by the *Tokios* tribunal that “[t]he twice-repeated discontinuance and revival of the criminal charges . . . create a poor impression and must have imposed a quite unnecessary strain . . . More than three years after the event, the . . . prosecuting authorities ought to have made up their minds whether or not to pursue the criminal charges. . . The most we can say is that they are part of a general picture which must be

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<sup>547</sup> Tr. 2, p. 94, lines 10-22.

<sup>548</sup> Luganova Affidavit, p. 16, para. 48.

<sup>549</sup> Luganova Testimony, Tr. 2, p. 99, lines 1-7.

<sup>550</sup> Luganova Affidavit, para. 48.

<sup>551</sup> Luganova Testimony, Tr. 2, p. 99, lines 8-25; p. 100, lines 1-7; p. 102, lines 2-14.

<sup>552</sup> Melnikov Testimony, Tr. 4, pp. 22-26.

<sup>553</sup> *Id.* at p. 73, lines 9-13.

looked at in its entirety when we come to decide what if any inferences can properly be made.”<sup>554</sup>

396. On December 16, 2005, a final meeting between Hotel and Alpha representatives took place in an effort to settle the dispute. Alpha was asked to agree to a retroactive termination of the 1998 and 1999 JAAs as well as to renounce “any and all property rights for any assets” emanating from its participation in the JAAs.<sup>555</sup> Alpha refused to do so. The minutes of the meeting indicate that, among others, Mr. Vladimir Ryzhy attended the meeting on behalf of Claimant. From September 2003 through May 2004, Mr. Ryzhy had been Chairman of the Hotel’s Supervisory Board. He submitted an affidavit on behalf of Claimant in which he testified that a “representative of the State Administration of Affairs” attended the meeting, and that this was so even though the “draft minutes” of that meeting (which Mr. Kuess never signed) do not reflect that presence.<sup>556</sup> According to Mr. Ryzhy, “[a]t the meeting, the representative of the State Administration of Affairs and representatives of OJSC Dnipro Hotel declared that the joint activity between Alpha and OJSC Dnipro Hotel must be terminated and distributed minutes of the meeting to that effect.” Mr. Kuess also testified that “[r]epresentatives of the State Administration of Affairs insisted that the agreements were not valid and proposed that Alpha should simply withdraw without compensation from the joint activities.”<sup>557</sup> Respondent asserted that there is no evidence that an SAA representative attended the meeting.<sup>558</sup> During the hearing, Mr. Kuess appeared to backtrack and stated that he only “deducted . . . that most probably representatives of the state were present then.”<sup>559</sup> However, the Tribunal sees no basis for discounting Mr. Ryzhy’s testimony in this regard. While the draft minutes do not reflect the participation of an SAA representative, the draft minutes were not prepared with Claimant’s participation and were not signed.

397. Having weighed the evidence, the Tribunal determines that this chain of events amply supports the conclusion that the State, primarily though not exclusively through the SAA in

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<sup>554</sup> *Tokios*, Award at para. 133.

<sup>555</sup> Doc. C-182.

<sup>556</sup> Doc. C-230, p. 2, paras. 4, 6 and 7.

<sup>557</sup> Kuess Affidavit, para. 40.

<sup>558</sup> Counter-Memorial, para. 202

<sup>559</sup> Kuess Testimony, Tr. 1, p. 187, lines 18-19.

possible coordination with the State Property Fund, instructed the Hotel to discontinue payments to Alpha in June 2004 and is responsible for the continuing failure of the Hotel to meet its contractual obligations under the amended 1998 and 1999 JAAs.

398. The Tribunal notes that it was not until two years after the stop in payments, in August 2006, that the Deputy Public Prosecutor of the City of Kiev finally filed a court claim on behalf of the Cabinet of Ministers and the SAA to invalidate the 1998 JAA. According to Mr. Kuess, Claimant was not notified of the proceeding until October 2006. It was not until October 2007 that the Deputy Public Prosecutor initiated a suit to invalidate the 1999 JAA, and, according to Mr. Kuess, Alpha was never formally notified of the suit.<sup>560</sup> While the Tribunal is troubled by the lack of notice, in the Tribunal's view, submitting the dispute to local courts was the appropriate course for the State to follow if it wished to terminate the contracts rather than working outside established procedures to instruct (explicitly or implicitly) the Hotel to cease payments to Claimant.

399. The parties spent significant time arguing as to whether the stop in payments was attributable to Respondent based on the principles of attribution articulated in the Articles on Responsibility of States for Internationally Wrongful Acts that the International Law Commission issued in 2001 (the "ILC Articles").<sup>561</sup> In light of the Tribunal's finding that the Ukrainian government was directly responsible for the cessation of payments, questions regarding Ukraine's responsibility under international law are greatly simplified.

400. The parties presented arguments under Articles 4, 5, and 8 of the ILC Articles. Article 4(1) states in pertinent part that "[t]he conduct of any State organ shall be considered an act of that State under international law, whether the organ exercises legislative, executive, judicial or any other functions, whatever position it holds in the organization of the State, and whatever its character as an organ of the central Government or of a territorial unit of the State." Article 5

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<sup>560</sup> Kuess Affidavit, para. 41.

<sup>561</sup> Draft Articles on Responsibility of States for Internationally Wrongful Acts, with commentaries, *in* Report of the International Law Commission on the Work of Its Fifty-third Session, UN GAOR, 56th Sess., Supp. No. 10, at 43, UN Doc. A/56/10 (2001), available at [http://untreaty.un.org/ilc/texts/instruments/english/commentaries/9\\_6\\_2001.pdf](http://untreaty.un.org/ilc/texts/instruments/english/commentaries/9_6_2001.pdf). ("ILC Commentary").

states in pertinent part that “[t]he conduct of a person or entity which is not an organ of the State under article 4 but which is empowered by the law of that State to exercise elements of the governmental authority shall be considered an act of the State under international law, provided the person or entity is acting in that capacity in the particular instance.” Finally, Article 8 provides that “[t]he conduct of a person . . . shall be considered an act of a State under international law if the person . . . is in fact acting on the instructions of, or under the direction or control of, that State in carrying out the conduct.”

401. The Tribunal has concluded that the SAA (alone or with other State actors) instructed the cessation of payments. SAA being a State organ as described above, such action is clearly attributable to the State under Article 4(1) of the ILC Articles. The Tribunal makes two additional observations on this point, as they are relevant to the disposition of Claimant’s claims.

402. First, whether the stop in payments was based on commercial or other reasons is irrelevant with respect to the question of attribution. The Commentary to Article 4 states as follows:

It is irrelevant for the purposes of attribution that the conduct of a State organ may be classified as “commercial” or as *acta iure gestionis*. Of course, the breach by a State of a contract does not as such entail a breach of international law. Something further is required before international law becomes relevant, such as a denial of justice by the courts of the State in proceedings brought by the other contracting party. But the entry into or breach of a contract by a State organ is nonetheless an act of the State for the purposes of article 4, and it might in certain circumstances amount to an internationally wrongful act.<sup>562</sup>

403. Second, while the Commentary notes that a breach of contract alone does not entail a breach of international law, the events giving rise to this dispute go far beyond mere breach of contract. In fact, as Respondent itself argued repeatedly, the State itself was not even a party to the JAAs,<sup>563</sup> and thus the question does not arise as to whether the “State” engaged in a breach of contract. The contract was between Claimant and the Hotel. While the Hotel was owned by the

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<sup>562</sup> ILC Commentary at p. 41, para. (6).

<sup>563</sup> See, e.g., Counter-Memorial, para. 199 (“Ukraine did not assume responsibility for the commercial commitments of the Hotel Dnipro and was not obliged to guarantee and perform payments under the joint activity agreements with the Claimant”); Counter-Memorial, para. 208 (“the State of Ukraine has not assumed any contractual obligations of the Hotel Dnipro with respect to Claimant”).

State, and while the Hotel's failure to make monthly payments to Claimant and to continue to operate the floors as a joint activity breached the terms of the JAAs, the Hotel was not acting as an organ of the State when it entered into the contracts. It was the Hotel, not the State, that entered into the contracts, and the Hotel, not the State, that breached the contracts. However, it was Ukraine's conduct that interfered with the contracts and caused the Hotel to breach the contracts outside proper channels, and it is that conduct that is unquestionably State conduct and that implicates Ukraine's international responsibility.

### **C. Whether Claimant's Investment was Expropriated**

#### **1. Positions of the Parties**

404. Claimant asserted that Respondent expropriated its rights under the JAAs in violation of Article 4(1) of the UABIT, which states that “[i]nvestments of investors of either Contracting Party shall not be expropriated in the territory of the other Contracting Party except for a purpose which is in the public interest, by the due process of law and against the payment of adequate compensation.”<sup>564</sup> In Claimant's view, Respondent's actions amounted to an indirect expropriation of Claimant's rights. In this respect, Claimant drew attention to the definition of “expropriation” set forth in Article 1(4) of the UABIT, which includes not only “nationalization” but also “any other measure taken by one Contracting Party having equivalent effects with respect to investments of an investor of the other Contracting Party.”<sup>565</sup>

405. Claimant emphasized that the ILC Articles incorporate the notion of indirect expropriation in general terms in Article 15(1), which states that “[t]he breach of an international obligation by a State through a series of actions or omissions defined in aggregate as wrongful occurs when an action or omission occurs which, taken with the other actions or omissions, is sufficient to constitute the wrongful act.”<sup>566</sup> Claimant characterized this principle as “introducing the notion of a ‘composite wrongful act’” and pointed to Comment (7) to Article 15(1), which states that “[i]t is only subsequently that the first action will appear as having, as it were, inaugurated the series. Only after a series of actions or omissions takes place will the

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<sup>564</sup> Request, p. 11.

<sup>565</sup> Claimant's First Post-Hearing Submission, p. 7.

<sup>566</sup> Claimant's Second Post-Hearing Submission, p. 19.

composite act be revealed, not merely as a succession of isolated acts, but as a composite act, i.e., an act defined in aggregate as wrongful.”<sup>567</sup> Claimant maintained that, where creeping expropriation is concerned, the “essence of such a claim is that the total is greater than the sum of its parts, that what is plainly wrong when viewed in its totality may be composed of a number of bits and pieces, some portion of which might withstand scrutiny if examined one by one.”<sup>568</sup>

406. Claimant also cited a 2000 UNCTAD survey for the proposition that the “indirect expropriation concept was developed to address measures which fall short of one-shot physical takings but which nonetheless result in the effective loss of management, use, control, or a significant depreciation in the value, of the assets of a foreign investor” (citation omitted).<sup>569</sup> Claimant argued that the facts of this case satisfy these “hallmarks” of indirect expropriation and particularly of “creeping expropriation” due to the “length of time involved.”<sup>570</sup> In Claimant’s judgment, the events spanning 2003 and 2004 had a “continuing and irreversible effect on Alpha’s property rights.”<sup>571</sup> Claimant concluded that “[t]he passage of time has demonstrated that Alpha has been permanently deprived of the fundamental rights of participation in the joint activities . . . . Alpha no longer has any use of its investment and no reasonable prospect of any further return thereon.”<sup>572</sup>

407. Respondent argued that (1) the actions of the Hotel are not attributable to Ukraine; (2) it has not been proven that Claimant has been deprived of value, particularly given that Claimant could seek to enforce the contracts in court; and (3) the decision to stop payments was a commercial decision and did not involve any exercise of sovereign powers by the State.<sup>573</sup>

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<sup>567</sup> *Id.*

<sup>568</sup> *Id.* at p. 20.

<sup>569</sup> *Id.* at p. 17.

<sup>570</sup> *Id.* at p. 18. Claimant cites a number of cases in support, such as *Starrett Housing Corp. v. Iran*, Award No. ITL 32-24-1, 4 Iran-United States Cl. Trib. Rep. 122 (1983) (“*Starrett Housing*”), *CMS v. Argentina*, ICSID Case No. ARB/01/8, Award, May 12, 2005 (“*CMS Gas*”); *Rumeli v. Kazakhstan*, ICSID Case No. ARB/05/16, Award, July 29, 2008 (“*Rumeli*”); *LG&E v. Argentina*, ICSID Case No. ARB/02/1, Decision on Liability, October 3, 2006 (“*LG&E, Liability*”) and *Generation Ukraine v. Ukraine*, ICSID Case No. ARB/00/9, Award, September 16, 2003. Claimant’s Second Post-Hearing Submission, pp. 18-19.

<sup>571</sup> Claimant’s Second Post-Hearing Submission, p. 20.

<sup>572</sup> *Id.* at pp. 19-20.

<sup>573</sup> Counter-Memorial, para. 319.

## 2. Tribunal's Findings

408. It is well-established that a government action need not amount to an outright seizure or transfer of title in order to amount to an expropriation under international law. As the Iran-United States Claims Tribunal found in *Starrett Housing*, “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 expropriated them and the legal title to the property formally remains with the original owner.”<sup>574</sup> Thus, even if the 1998 and 1999 JAAs remain nominally in force, Claimant’s investment may still have been expropriated if the contracts have been “rendered useless” by the actions of the Ukraine government. However, in order to establish an indirect expropriation of this sort, it is necessary to demonstrate that the investment has been deprived of a significant part of its value.<sup>575</sup>

409. The evidence is plain that Claimant has been deprived of all remaining value of the 1998 and 1999 JAAs. Since the cessation of payments in June 2004, Claimant has not received any remuneration under either agreement. Respondent has not given any indication that it intends to allow the Hotel to resume payments, nor has the Hotel independently indicated that it would resume payments. It is also evident that the Hotel will not pay Claimant any share of the terminal value of the joint activities. All evidence indicates that the cessation of payments is permanent and that Claimant has been deprived of substantially all remaining economic value in the agreements.

410. Given that Claimant’s investment has been substantially deprived of value, that such deprivation is effectively permanent, and that the deprivation was the result of government action, the Tribunal finds that Claimant’s rights under the JAAs have been expropriated in violation of Article 4(1) of the UABIT.

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<sup>574</sup> *Starrett Housing* at p. 154.

<sup>575</sup> See, e.g., *Metalclad v. Mexico*, ICSID CASE No. ARB(AF)/97/1, Award, August 30, 2000, para. 103 (“*Metalclad*, Award”) (“expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State”).

411. With respect to Respondent’s first objection, the Tribunal has already determined that the stop in payments was caused by Ukraine’s conduct. The Tribunal has also dispensed with Respondent’s second objection, *i.e.*, that the contracts are not deprived of substantially all value. There is no prospect that payments will resume or that Claimant will be paid any terminal value for its share of the joint activity. Whether Claimant could have enforced its rights in local courts, and whether the JAAs are technically still in effect as Respondent alleges,<sup>576</sup> is not relevant to this question. Claimant chose to seek a remedy through international arbitration instead, as it is entitled to do.

412. Respondent’s third objection is that the decision to stop payments was a purely commercial decision and did not involve the exercise of sovereign powers. The Tribunal questions whether any distinction between “sovereign” and “commercial” actions is relevant to the question of whether Ukraine’s actions expropriated Claimant’s investment. However, even assuming a distinction is relevant, the Tribunal nevertheless concludes that Ukraine expropriated Claimant’s investment. The Tribunal has already addressed the means of pressure the government exerted that went beyond the bounds of the legal procedures set forth in the Hotel’s charter for entering into and managing the Hotel’s contracts. Furthermore, Respondent has consistently argued that the contracts at issue here were not with the State but with the Hotel,<sup>577</sup> and the Hotel at least nominally had authority to act independently of the government with respect to the management of the contracts. If that is correct, then this is not a case of a state breaching a contract for commercial reasons. It is, instead, a case where a state caused a commercial entity to breach that entity’s contractual obligations.

## **D. Whether Claimant was Denied Fair and Equitable Treatment**

### **1. Positions of the Parties**

413. Claimant asserted that Respondent has breached Article 2 of the UABIT,<sup>578</sup> which states in pertinent part that “[e]ach Contracting Party shall in its territory promote, as far as possible,

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<sup>576</sup> *See, e.g.*, Rejoinder, para. 136 (“the JAAs remain formally legally effective”).

<sup>577</sup> Counter-Memorial, para. 337.

<sup>578</sup> Request, p. 8, para. 25.



investments of investors of the other Contracting Party, admit such investments in accordance with its legislation and in each case accord such investments fair and equitable treatment.”

414. Claimant argued that “[h]aving created over a prolonged time span expectations on Alpha’s part that were enormously beneficial to the State, Respondent cannot conveniently abrogate those expectations when it becomes convenient for it to do so.”<sup>579</sup> Claimant cited the Award in *Tecmed*<sup>580</sup> in support of the argument that the guarantee of fair and equitable treatment prohibits State action that adversely affects the “investor’s basic expectations in making the investment.”<sup>581</sup>

415. Respondent argued that Claimant has failed to identify any legitimate expectations that were undermined by the actions of Ukraine. Respondent asserted that any expressed expectation by Claimant “to renovate the whole Hotel and subsequently to privatise it are nothing more than invention for purposes of this arbitration.”<sup>582</sup> Furthermore, Respondent noted that Claimant has admitted that it was not knowledgeable about Ukrainian law and that it relied in this regard on statements made by the Hotel’s management and by Ukrainian state officials. Given Claimant’s lack of due diligence, Respondent argued, Respondent cannot be blamed if Claimant’s expectations were unfounded.<sup>583</sup> In any case, according to Respondent, Claimant has not demonstrated that any advice attributable to Ukraine was incorrect and Claimant cannot base any legitimate expectations on contracts that were intrinsically flawed.<sup>584</sup>

## 2. Tribunal’s Findings

416. For the reasons explained below, the Tribunal finds that Respondent breached its obligations under Article 2(1) of the UABIT.

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<sup>579</sup> Reply, p. 21.

<sup>580</sup> *Técnicas Medioambientales Tecmed, S.A. v. United Mexican States*, ICSID Case No. ARB (AF)/00/2, Award, May 29, 2003 (“*Tecmed*”).

<sup>581</sup> Claimant’s First Post-Hearing Submission, p. 22.

<sup>582</sup> Rejoinder, para. 178.

<sup>583</sup> *Id.* at paras. 183-185.

<sup>584</sup> *Id.* at paras. 186-188.

417. As an initial matter, and in addition to the objections noted above, Respondent raised two interpretive issues with respect to Article 2(1). First, it asserted that the principle of fair and equitable treatment under the UABIT relates only to conduct during the “pre-investment period” because Article 2(1) deals primarily with “promotion” of foreign investment.<sup>585</sup> The Tribunal does not accept this interpretation. Article 2(1) of the UABIT states that each Contracting Party shall promote investments “*and* in each case accord such investments fair and equitable treatment” (emphasis added). The conjunction “and” indicates that these are separate and independent obligations, and the obligation to provide fair and equitable treatment extends to the protection of existing investments.

418. Second, Respondent asserted that the term “equitable” implies that the obligation requires equality of treatment among similarly situated investors. Respondent argued that “the ordinary meaning of this word combination [*i.e.*, fair and equitable treatment] prompts its closest similarity to ‘non-discrimination.’”<sup>586</sup> In addition, Respondent contended that the Ukrainian language version speaks of “equal in rights,” a phrase which, in Respondent’s opinion, “inevitably leads” to the conclusion that the treatment in question must be compared to the treatment of others “in similar situations.”<sup>587</sup>

419. The Tribunal rejects Respondent’s interpretation. While, in certain cases, discriminatory treatment may give rise to a violation of fair and equitable treatment, in most cases discriminatory government actions are more properly judged against the requirements of national treatment and most-favored nation treatment, which appear in Article 3 of the UABIT. Furthermore, the principle of fair and equitable treatment is well-established in international law, and there is no evidence that the Parties to the UABIT intended to deviate from that principle in drafting Article 2.

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<sup>585</sup> Respondent’s First Post-Hearing Submission, para. 91.

<sup>586</sup> Respondent’s Second Post-Hearing Submission, para. 44.

<sup>587</sup> Respondent’s First Post-Hearing Submission, para. 91.

420. In the Tribunal's view, the principle of fair and equitable treatment includes the obligation not to upset an investor's legitimate expectations<sup>588</sup> and the obligation to avoid arbitrary government action, regardless of whether there is any discriminatory element involved.<sup>589</sup> As stated by the *Vivendi* tribunal, the fair and equitable treatment standard is an "an objective standard."<sup>590</sup> As stated in an UNCTAD report, "where the fair and equitable standard is invoked, the central issue remains simply whether the actions in question are in all the circumstances fair and equitable or unfair and inequitable."<sup>591</sup> This means, in part, that governments must avoid arbitrarily changing the rules of the game in a manner that undermines the legitimate expectations of, or the representations made to, an investor.<sup>592</sup>

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<sup>588</sup> The tribunal in *Tecmed* stated that the fair and equitable treatment obligation, "in light of the good faith principle established by international law, requires the Contracting Parties to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment." *Tecmed* at para. 154. The tribunal in *Siemens* surveyed recent case law and determined that "the current standard includes the frustration of expectations that the investor may have legitimately taken into account when it made the investment." *Siemens A.G. v. Argentina*, ICSID Case No. ARB/02/08, Award, February 6, 2007, para. 299 ("*Siemens*").

<sup>589</sup> According to the tribunal in *LG&E*, the "stability of the legal and business framework in the State party is an essential element in the standard of what is fair and equitable treatment." *LG&E*, Liability at para. 125. The *Mondev International v. United States of America* tribunal, ICSID Case No. ARB(AF)/99/2, Award, October 11, 2002, para. 127, explained that a denial of fair and equitable treatment could be found when a government action was "clearly improper and discreditable." The tribunal in *Azurix* concluded that "[i]n their ordinary meaning, the terms 'fair' and 'equitable' used in . . . the BIT mean 'just', 'even-handed', 'unbiased', 'legitimate.'" *Azurix Corp. v. Argentina*, ICSID Case No. ARB/01/12, Award, July 14, 2006, para. 360 (citing the Oxford English Dictionary).

<sup>590</sup> *Compania de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentina*, ICSID Case No. ARB/97/3, Award, August 20, 2007, para. 7.4.12 ("*Vivendi*"). The tribunal cited *CMS Gas* at para. 280, for the proposition that the fair and equitable treatment standard is "unrelated to whether the Respondent has had any deliberate intention or bad faith in adopting the measures in question. Of course, such intention and bad faith can aggravate the situation but are not an essential element of the standard."

<sup>591</sup> UNCTAD, *Fair and Equitable Treatment* 40, UNCTAD Series on Issues in International Investment Agreements, (1999).

<sup>592</sup> See, e.g., *CMS Gas* at para. 277 ("It is not a question of whether the legal framework might need to be frozen as it can always evolve and be adapted to changing circumstances, but neither is it a question of whether the framework can be dispensed with altogether when specific commitments to the contrary have been made. The law of foreign investment and its protection has been developed with the specific objective of avoiding such adverse legal effects"). See also, *Tecmed* at para. 154 ("The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations. . . . The foreign investor also expects the host State to act consistently, i.e. without arbitrarily revoking any preexisting decisions or permits issued by the State that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities. The investor also expects the State to use the legal instruments that govern the actions of the investor or the investment in conformity with the function usually assigned to such instruments, and not to deprive the investor of its investment without the required compensation.")

421. The Tribunal agrees with Respondent that Claimant has not articulated with precision what “legitimate expectations” it possessed that Ukraine has undermined. The Tribunal also agrees with Respondent that Claimant did not possess any legitimate expectation that it would be able continue to work with the Hotel beyond the expiration of the current JAAs in 2015. No doubt Claimant hoped for a continuation of the relationship, and perhaps even the management of the Hotel harbored a similar hope. However, the contracts clearly provided for their termination in 2015, and it would be pure speculation to find that the parties would have extended the agreements further.

422. The Tribunal concludes, however, that Claimant did possess a legitimate expectation that the government would not interfere with the contractual relationship between Claimant and the Hotel, and that the agreements would be honored, albeit with the reformation to the payment terms necessitated by the Ukrainian law on joint activities as discussed below. Those expectations arose not only by the terms of the original agreements, but, for example, also by the terms of the amendments to those agreements negotiated during or after the corporatization, and by the assurances given by the new management of the Hotel in June 2004 that the relationship would continue. In effectively negating the agreements, Ukraine, and in particular the SAA, acted well beyond its authority as stated in the Hotel Charters and directly interfered with the day-to-day management of the Hotel. It thereby undermined Claimant’s legitimate expectations in violation of Article 2(1) of the UABIT.

### **E. Umbrella Clause**

423. Claimant’s third claim is based on Article 8(2) of the UABIT, which states that “[e]ach Contracting Party shall observe any contractual obligations which it may have assumed with respect to an investor of the other Contracting Party regarding investments approved by it in its territory.”<sup>593</sup> Claimant argued that Respondent failed “to respect the contractual obligations which Respondent undertook vis-a-vis Claimant.”<sup>594</sup> Respondent, on the other hand, argued that

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<sup>593</sup> Request, p. 8, para. 25.

<sup>594</sup> *Id.* at p. 11.

Article 8(2) of the UABIT is inapplicable because the State has not entered into any contract with Claimant.<sup>595</sup>

424. The Tribunal agrees with Respondent that the contracts were between Claimant and the Hotel, not between Claimant and Respondent. The Tribunal further concludes that the Hotel was not acting as an organ of the State when it entered into the contracts. Consequently, Respondent “assumed” no contractual obligations with respect to Claimant and did not violate Article 8(2) of the UABIT.

#### **F. National Treatment**

425. Late in the written pleadings, Claimant charged for the first time that Respondent’s conduct violated the “national treatment” guarantee found in Article 3(1) of the UABIT,<sup>596</sup> which states that “[e]ach Contracting Party shall accord to investors of the other Contracting Party and their investments treatment no less favourable than that which it accords to its own investors and their investments or to investors in third States and their investments.” Claimant argued that various provisions of Ukrainian law prohibit the government from interfering with private ownership interests. Under these rules, if the government engages in such interference, the injured party is entitled to restoration of the *status quo ante* or, where that is impossible, compensation.<sup>597</sup> Claimant concluded that Respondent breached its obligations to Alpha under Ukrainian domestic law and, accordingly, has denied Claimant national treatment.<sup>598</sup> Respondent sees no distinction between the treatment of Alpha and the treatment of domestic Ukrainian investors.<sup>599</sup>

426. In order to prove a national treatment violation, it is necessary first and foremost to establish that a government action or inaction has discriminated between domestic and foreign investors, *i.e.*, that it has accorded “less favourable” treatment to foreign as opposed to domestic investors. Such discrimination could arise *de jure* if there is a government measure such as a law

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<sup>595</sup> Counter-Memorial, p. 94, para. 337.

<sup>596</sup> Claimant’s First Post-Hearing Submission, p. 9.

<sup>597</sup> *Id.*

<sup>598</sup> *Id.* at p. 10.

<sup>599</sup> Respondent’s Second Post-Hearing Submission, para. 52, pp. 13-14.

or regulation that explicitly discriminates between domestic and foreign investors, or *de facto* if the measure is not explicitly or inherently discriminatory but discriminates between domestic and foreign investors in the way in which it is applied.

427. As stated by the tribunal in *S.D. Myers*, “[i]ntent is important [in proving a national treatment violation], but protectionist intent is not necessarily decisive on its own.”<sup>600</sup> Indeed, in that case, the tribunal concluded that the government’s motives in taking the action giving rise to the dispute may have had a legitimate objective, but that the method adopted by the government in achieving that objective was inconsistent with its obligations under the treaty.<sup>601</sup>

428. Unlike national treatment provisions in many other investment agreements, the UABIT does not expressly state that discrimination must be between investors that are “like” or otherwise similarly situated.<sup>602</sup> The Tribunal need not resolve the question of whether Article 3(1) of the UABIT should be interpreted to include such a limitation, as Claimant has not proven a national treatment violation of any sort, whether limited to investors in “like circumstances” or not so limited. Indeed, the Tribunal has difficulty understanding the claim that Claimant has asserted in this regard. Claimant has not established that Ukrainian law entitles Ukrainian investors to any different treatment than investors from Austria, nor has it pointed to any instance where Ukrainian investors were, in fact, treated differently. Consequently, there is no basis for finding that Ukraine breached its obligations under Article 3(1) of the UABIT.

## **G. Claims Under Ukrainian Law**

### **a. Positions of the Parties**

429. Claimant contended<sup>603</sup> that Respondent violated Ukraine’s 1996 Foreign Investment Law, Article 9 of which states that “[f]oreign investments in Ukraine shall not be nationalized. State

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<sup>600</sup> *S.D. Myers v. Canada*, First Partial Award, November 14, 2000, para. 254 (“*S.D. Myers*”).

<sup>601</sup> *Id.* at para. 255.

<sup>602</sup> Several tribunals have explored the significance of a requirement to prove discrimination between investors “in like circumstances.” See, e.g., *Marvin Feldman v. Mexico*, ICSID Case No. ARB(AF)/99/1, Award, December 16, 2002, para. 171; *Occidental Exploration and Production Company v. Ecuador*, London Ct. of Int’l Arb. Case No. UN 3467, Award, July 1, 2004, para. 173; and *S.D. Myers*, para. 250.

<sup>603</sup> Memorial, p. 24, para. 16.

bodies may not seize foreign investments, with the exception of emergency measures in the event of natural disaster, accidents, epidemics or epizootic.” Claimant argued that the provisions of the FIL are “parallel” to the expropriation provisions found in the UABIT,<sup>604</sup> and claimed that Respondent violated the FIL by seizing Alpha’s property rights and terminating the joint activities without respecting the procedural rights and duties owing to Claimant.<sup>605</sup> Claimant also noted that Article 7 of the FIL guarantees foreign investors national treatment. Finally, Claimant asserted that it was entitled to reinstatement of its property under the Ukraine Civil Code,<sup>606</sup> various other provisions of Ukrainian law,<sup>607</sup> and Article 11 of the FIL.<sup>608</sup>

430. Respondent argued that Claimant has failed to prove any “essential deprivation” of the benefits of its investments or to show any governmental “measures” that brought about an “effect equivalent to expropriation.”<sup>609</sup> In any case, Respondent argues, the JAAs have not been “terminated.”<sup>610</sup> Finally, in Respondent’s view, the UABIT and the ICSID Convention control this dispute, and the FIL is inapplicable.<sup>611</sup>

431. With respect to Claimant’s assertion that it is entitled to reinstatement of its rights under the Civil Code, Respondent argued that Claimant has not initiated a claim in local courts in accordance with Article 393 of the Ukraine Civil Code, which provides a right to institute a court suit in the event of infringement of rights by the act of a public authority. Furthermore, Respondent argued that Article 393 only provides for restoration of infringed property rights, and that Claimant has not shown any such infringement in this case.<sup>612</sup>

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<sup>604</sup> *Id.*

<sup>605</sup> *Id.* at p. 25, para. 17.

<sup>606</sup> *Id.* at p. 27, para. 23. Claimant asserts that Article 319.6 of the Civil Code prohibits the State from interfering with ownership rights and that Article 393.2 requires restoration of the *status quo ante* to the owner. Claimant’s First Post-Hearing Submission, p. 9.

<sup>607</sup> Claimant’s First Post-Hearing Submission, p. 9, citing Law No. 697 “On Property,” the Commercial Code of Ukraine, and Law No. 1560 “On Investment Activity.”

<sup>608</sup> Claimant’s First Post-Hearing Submission, p. 8.

<sup>609</sup> Rejoinder, p. 48, para. 172.

<sup>610</sup> Respondent’s Second Post-Hearing Submission, p. 13, para. 50.

<sup>611</sup> Counter-Memorial, p. 31, para. 104.

<sup>612</sup> *Id.* at p. 96, para. 346.

## **b. Tribunal's Findings**

432. The Tribunal notes that Article 6 of the FIL states that “[i]f an international agreement of Ukraine provides rules other than that provided for by the legislation of Ukraine, the rules of the international agreement shall apply.” Thus, under Ukrainian law, and at least where there is overlap between the UABIT and Ukrainian law, the UABIT alone governs the merits of the dispute rather than the FIL, the Civil Code, or any other provision of Ukraine domestic law. On this basis alone, the Tribunal rejects Claimant’s domestic law claims. Even if that were not the case, however, the Tribunal finds that Claimant has not sustained its burden of proving violations of Ukrainian domestic law.

433. As a general matter, the Tribunal notes that in many cases, Claimant simply provided citations to law or quotations with little or no argumentation. For example, in its Post-Hearing Brief, it refers to Law No. 1560, “On Investment Activity,” and provides a string of quotations and paraphrases of sections of the law with no argumentation or citation to relevant legal authorities.<sup>613</sup> The same is true with respect to, for example, Claimant’s references to Article 48.4 of Law No. 697 and Article 147 of the Commercial Code.<sup>614</sup> These types of references do not suffice to sustain Claimant’s burden of proof. Even when Claimant provided more than a line or two of explanation, Claimant’s failed to prove its claims.

434. With respect to Article 9 of the FIL, it is not clear to the Tribunal that the prohibition against nationalizations and seizures is broad enough to encompass indirect expropriations. While this very well may be the case, Claimant has not provided sufficient evidence to support its claim.

435. With respect to Article 7 of the FIL, the Tribunal rejects Claimant’s assertion of a national treatment violation for the same reasons according to which the Tribunal rejected Claimant’s assertion of a national treatment violation under the UABIT. Claimant has simply failed to show any government action that discriminated against its investment as compared to the investments of domestic investors.

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<sup>613</sup> Claimant’s First Post-Hearing Submission, pp. 9-10.

<sup>614</sup> *Id.* at p. 9.



436. Finally, the Tribunal understands Claimant to be relying on Article 393 of the Civil Code to support its contention that it is entitled to restoration of the *status quo ante*. While this issue pertains to damages, the Tribunal shall address it here. The Tribunal has not found a violation of Ukrainian domestic law in this case, and Claimant has not explained to the Tribunal why Article 393's application would extend beyond violations of domestic law. Furthermore, Article 393 specifically provides for compensation when it is impossible to restore the *status quo ante*. At this stage, more than six years after the cessation of payments, it is the view of the Tribunal that it is not possible to restore the *status quo ante*. Compensation is, therefore, the appropriate remedy. According to the Tribunal, the amount of compensation must put Claimant in the situation, in which it would have been if Respondent had not breached the UABIT. The Tribunal will apply this principle with respect to the violation of any UABIT protection. The Tribunal notes, however, that the compensation it will award is intended to substitute for the restoration of the *status quo ante*, that is, it is intended to put Claimant in the situation as if the JAAs had been properly performed. Therefore, once Claimant is awarded compensation, it will have no right to specific performance.

#### **H. Conclusion with Respect to the Merits of Claimant's Claims**

437. On the basis of the foregoing, the Tribunal concludes that Ukraine has expropriated Claimant's investment and denied Claimant fair and equitable treatment in violation of Articles 4(1) and 2 of the UABIT respectively. The Tribunal dismisses Claimant's other claims.

438. Before proceeding to the damages section of the Award, the Tribunal shall examine in the next section the content and nature of Claimant's rights under the 1998 and 1999 JAAs, as amended, in order to determine the exact scope of Claimant's injury.

### **VIII. Content and Nature of Rights Affected by Government Action**

#### **A. Whether the JAAs Constituted Legitimate Joint Activities**

439. All of Claimant's claims under the UABIT are predicated on the assertion that certain actions allegedly taken by Ukraine extinguished or damaged Claimant's investment, *i.e.*, its rights under the 1998 and the 1999 JAAs. In order to assess Claimant's claims for purposes of

calculating Claimant's injury, and, therefore, the damages to which it is entitled pursuant to the Tribunal's liability determination above, it is necessary to define with precision the scope and nature of those rights. With respect to this issue, the parties' primary disagreement is whether the contractual relationship between Claimant and the Hotel is a legitimate "joint activity" or whether it constitutes some other form of commercial relationship. If the relationship is a joint activity, Ukrainian law imposes certain rights and obligations on the parties which, in turn, help define Claimant's right and interests in the JAAs.

440. In resolving these questions, the Tribunal is guided primarily by the Ukraine Civil Code. While the Ukraine Civil Code did not enter into force until January 1, 2004, it nevertheless applies to both the 1998 and the 1999 JAAs. According to Claimant: "As provided in Clause 4 of the Ukrainian Civil Code Interim Provisions, the Civil Code is to be applied not only to civil relations arising after its effective date but also to those rights and obligations of pre-existing relationships that continued to exist after the Code's effective date. Clause 9 of the Ukrainian Civil Code Interim Provisions explicitly provides that joint activity agreements entered into before 01 January 2004 but continuing in force thereafter are subject to the Civil Code. Hence the 1998 JAA and the 1999 JAA are both covered by the Civil Code."<sup>615</sup>

441. The parties agree that, in a legitimate joint activity, each of the parties makes an original economic contribution, which the parties then use as a basis for generating a future income stream. The parties are entitled to a share of the profits generated by the project and, upon termination of the joint activity, a share of the assets held by the joint activity. Respondent does not take issue with this description of a joint activity, but argues that the contractual arrangements between Claimant and the Hotel do not, in fact, establish a joint activity. Instead, Respondent argues, the JAAs are "pretended agreements" that are joint activity agreements in

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<sup>615</sup> Claimant's Memorial, p. 20, para. 3. *See also*, Omelchenko Opinion, para. 1.4 ("As of the date of entering into the 1994 General Agreement, the 1998 JAA and the 1999 JAA, legal relationships of the kind established by these agreements were regulated by the [Civil Code] of the USSR. Since 01 January 2004, when the new Civil Code of Ukraine ('CC') entered into force, this new CC governed the contractual relationships set forth by the 1998 JAA and the 1999 JAA").

name only.<sup>616</sup> As discussed above, Respondent characterizes the agreements as loan or construction agreements rather than as legitimate joint activity agreements.

442. The Tribunal finds that the 1998 JAA and the 1999 JAA are legitimate joint activity agreements. Not only are the contracts formally cast as joint activity agreements on their face, they also exhibit critical characteristics of a joint activity including profits sharing, specified contributions by the parties, and a division of assets in accordance with the parties' contributions. Furthermore, as discussed above, the contemporaneous legal opinions by Hotel counsel, Messrs. Rozenblit and Bozhenko, separately concluded that the agreements constituted legitimate joint activities. While there may have been legal infirmities with the pre-1998 agreements, the 1998 JAA corrected any such deficiencies. On this basis, the Tribunal concludes that the contracts are, in fact, joint activity agreements under Ukrainian law and not mere loan or construction agreements.

443. However, this is not the end of the inquiry. For the reasons explained below, the Tribunal also concludes that there were defects in the operation of the JAAs that require modification of the contractual terms.

### **B. Effect of the Minimum Monthly Payment Provisions**

444. A key issue in dispute between the parties is the validity of the minimum monthly payment provisions in the 1998 and 1999 JAAs, particularly in situations where the respective joint activity would experience a loss either independently or precisely because of the minimum monthly payment obligation. Respondent asserts that the minimum monthly payment provisions insulated Claimant from paying its share of expenses and deprived the Hotel of virtually any income and that, consequently, such provisions are impermissible under Ukraine's law on joint activities. While Claimant concedes that the default rule under Ukrainian law is that the profits from a joint activity should be divided between the parties in proportion to their original contributions, Claimant also notes that Ukrainian law permits parties to a joint activity to negotiate an alternate division of profits.

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<sup>616</sup> Counter-Memorial, para. 212.

445. The Tribunal notes, however, that even Claimant’s expert, Professor Omelchenko, recognizes that the parties to a joint activity do not have a completely unfettered right to allocate profits and losses. According to Professor Omelchenko, if a joint agreement “stipulates that one of the parties is entitled to a fixed amount of profits, and this cannot be paid out of the results of the joint activities, it is necessary to change the terms and conditions of the agreement.”<sup>617</sup> In the first instance, according to Professor Omelchenko, the change is to be negotiated between the parties, and “[u]ntil such time as these things are contractually changed, the terms and conditions remain the same as they were stated before. If we cannot agree on these new terms and conditions, of course one of the parties can go to tribunals.”<sup>618</sup> Professor Omelchenko thus implies that an adjudicating court or tribunal would have the power to modify or void the contract.

446. Separately, Claimant argued that Article 652 of the Civil Code requires that when the parties to a contract “face significantly changed circumstances,” they should seek to reach agreement upon a “mutually acceptable amendment,” failing which, they may submit the issue to a court.<sup>619</sup> On this basis, according to Claimant, it was “incumbent” on the Hotel to have sought “to amend one or both of the JAAs to accommodate” whatever the Hotel perceived as a supervening obstacle to performance,<sup>620</sup> and the Hotel should not have unilaterally ceased complying with the contracts.

447. Respondent’s expert, Professor Maydanyk, argued that the parties to a joint activity cannot agree to allocate “profits” to one party that exceed the net revenues of the joint activity. He asserted that if such payments exceed revenues, then they are not “profits” at all. According to Professor Maydanyk, “[w]hen we fix a payment in an agreement, practically speaking we are no longer talking of profits, we are talking of payments and this is the main violation and the reason why such terms are considered as nil.”<sup>621</sup> In this case, he asserted, the provision of a

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<sup>617</sup> Omelchenko Testimony, Tr. 4, p. 192, lines 14-18.

<sup>618</sup> *Id.* at p. 193, lines 12-16.

<sup>619</sup> Claimant’s First Post-Hearing Submission, p. 30.

<sup>620</sup> *Id.* at p. 31.

<sup>621</sup> Maydanyk Testimony, Tr. 5, p. 171, lines 6-10.

“guaranteed” minimum payment under the JAAs was “void” because Articles 1137 and 1139 of the Ukraine Civil Code stipulate “the impossibility of limitations of benefits or losses.”<sup>622</sup>

448. The Tribunal finds that, based on the evidence and the argumentation presented by the parties, and for the reasons explained below, the minimum monthly payment provisions in the 1998 and the 1999 JAAs as amended are no longer valid.

### **1. Expenses and Losses**

449. Article 1137 of the Ukraine Civil Code states that a contractual provision “under which a participant is fully exempt from participation in reimbursement for joint expenses and losses shall be invalid.” The requirement to make minimum monthly payments to Claimant even in situations where the joint activity experiences a loss or where the minimum payment would itself force the joint activity into a loss is inconsistent with Article 1137. In such situations, Claimant could be “fully exempt from participation in reimbursement for joint expenses and losses.”

450. As noted above, Professor Omelchenko argued that (a) it is incumbent upon the parties to renegotiate the terms of their agreement in the event the agreement contains a minimum payment provision and the joint activity experiences a loss; but that (b) the minimum payment provision remains valid until such renegotiation is complete or a court orders reformation of the payment terms. However, if the parties are legally bound to renegotiate because the terms of the contract are illegal, or if a party is entitled to a court order for reformation of the contract because the original terms are impermissible, then it is not clear why or how the original provision would be enforceable in the interim, or why a court should not order reformation retroactively to the date when the circumstance first arose. Article 1137 is clear on this point – provisions exempting a party from its share of losses are invalid. The Tribunal finds that Claimant’s reliance upon Article 652 of the Civil Code for the contention that it was incumbent on the Hotel alone to seek an amendment is misplaced, as it pertains generally to a situation of changed circumstances, while Articles 1137 and 1139 pertain specifically to the regulation of joint activities and very

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<sup>622</sup> *Id.* at p. 165, lines 15-21 and p. 167, lines 8-13.

clearly state that provisions which deprive a party of its share of profits or insulate a party from bearing its share of expenses are void.

451. The Tribunal also notes that, as a practical matter, it is not clear why a party entitled to a minimum monthly payment would negotiate away its advantageous position, as Professor Omelchenko argues it would or should. In fact, the Tribunal notes that the minimum monthly payment provisions in the case at hand were not only favorable to Claimant at the outset, but that Claimant was able to exploit its advantageous position in order to negotiate even more favorable terms at the very time the Hotel was faced with a loss.

**a. 1998 JAA**

452. Based on the spreadsheet of profit and loss projections for the 1998 JAA (floors 11 and 12) provided by Claimant's own damages expert in LECG Exhibit CE-39<sup>623</sup> at page 2, the minimum monthly payment provisions would have forced the joint activity into a loss in every year from 2004-2013. For example, according to the spreadsheet, the joint activity would have earned a net profit in 2004 of USD 253,000 prior to the payment to Claimant. The USD 600,000 payment to Claimant (USD 50,000 per month) would have forced the joint activity into a net loss of USD 347,000. Under these circumstances, there is no sharing of expenses and losses. Rather, the Hotel was forced to pay the entire amount to Claimant, causing it to bear a loss while Claimant did not.

453. The Tribunal notes that the monthly payment provisions also put Claimant in a position of renegotiating even more favorable commercial terms. In late 2000, it became clear that the Hotel would experience a loss due to the need to incur certain expenses to improve the Hotel.<sup>624</sup> These expenses related to the Hotel as a whole, and it appears that they were necessary to allow the Hotel to upgrade the Hotel's infrastructure (including floors 8-12) to comply with international standards and to install a new phone system required by the Pechersk District.<sup>625</sup> In

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<sup>623</sup> See LECG Exhibit CE-39.

<sup>624</sup> The Tribunal recognizes that these events occurred prior to the entry into force of the 2004 Civil Code. The Tribunal is referring to this example for illustrative purposes only. Except where otherwise indicated, the same is true for the other examples discussed below regarding sharing of costs and profits that pre-dated 2004.

<sup>625</sup> See Kuess Affidavit, para. 29; Lukanova Affidavit, para. 24.

addition, it seems apparent from the record that the 1998 JAA would have experienced a loss at least in 2001 (and likely in 2000 or before) due simply to the minimum payment obligations. According to LECG Exhibit CE-39 at page 2, which was based on operational data for the Hotel from GEYA's 2003 Appraisal, the net profits generated under the 1998 JAA in 2001 were only USD 312,000, while the Hotel would have been required under the terms of the original 1998 JAA to pay Claimant USD 420,000 (USD 35,000 per month).

454. Rather than have the parties share the upgrade expenses, or at least an allocated portion of them proportional to the number of floors operated through the joint activities, the parties agreed to suspend payments to Claimant for a specified period of time. However, under the terms of the additional agreement, the minimum monthly amount ultimately owing to Claimant was to be increased from USD 35,000 to USD 50,000 and the term of the contract extended from 2004 to 2015. During the suspension period from September 1, 2000, through July 1, 2006, the Hotel's suspended payment obligation accrued as Hotel indebtedness, and the Hotel was required to repay those amounts after the close of the suspension period. In nominal terms, this meant that Claimant exchanged a future income stream of USD 1.6 million (covering the period 2000-2004) for a future income stream of USD 8.9 million (covering the period 2000-2015). Using a discount rate of 12.14%,<sup>626</sup> and discounting the income streams back to September 2000, Claimant's expected income under the original 1998 JAA was USD 1.232 million, while its expected revenue under the revised contractual terms was USD 3.324 million.<sup>627</sup>

455. A similar disproportionate outcome resulted during the negotiation of the so-called "reinvestment" in November 2003. The reinvestment was driven by the fact that the Hotel was

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<sup>626</sup> Claimant's expert used a 12.14% discount rate to calculate the net present value of Claimant's damages as of 2004. LECG Exhibit CE-39 at p. 4. The Tribunal has used the 12.14% discount rate to calculate the net present value of the Claimant's future income stream under the terms of the renegotiation in 2000 for illustrative purposes only.

<sup>627</sup> These figures assume a lump sum payment in 2006 of the suspended amounts. In addition, these figures are based on the minimum payment of USD 35,000 per month under the original 1998 JAA and the minimum monthly payment of USD 50,000 under the renegotiated 1998 JAA. As the purpose of these calculations is to determine the value of the renegotiated terms as of 2000, these figures do not take into account the "reinvestment" that the Hotel and Claimant negotiated in 2003. Claimant's expert estimated that Claimant would make a net payment of renovation costs of USD 733,000 in 2007. If these costs were included then, as of 2000, Claimant's nominal revenue stream from 2000-2015 under the 1998 JAA would be USD 7.567 million, and its discounted revenue stream would have been approximately USD 2.749 million.

facing a large tax assessment due to the continued accrual of the suspended payments on its books.<sup>628</sup> The Hotel could not afford to make these payments. Under the terms of the reinvestment, Claimant and the Hotel calculated what Claimant's share of the profits would have been during the period September 2000-June 2003 if it had been entitled to only 50% of the profits as opposed to the minimum monthly payments. It then treated this amount, which totaled USD 447,569, as a "reinvestment" under the 1998 JAA. It is not clear whether the reinvestment qualified as an additional contribution to the JAA by Claimant, whether this amount was still owed to Claimant after the suspension period, or whether Claimant was still owed the USD 1.7 million it would have been due for that September 2000-June 2003 period under the USD 50,000 minimum monthly payment provisions under the amended 1998 JAA.

456. The Tribunal notes that Claimant's damages calculation does not include a claim for lost profits during the period September 2000 - June 2003, which would imply at a minimum that Claimant was no longer owed the original USD 1.7 million after the reinvestment. Nevertheless, the outcome of the negotiation was disproportionately in Claimant's favor. Claimant asserts that, in exchange for the reinvestment, the parties agreed to extend the term of the 1999 JAA from June 30, 2006, to June 30, 2015, with minimum monthly payments to Claimant during that time of USD 50,000.<sup>629</sup> For illustrative purposes, assume that Claimant did not receive any credit for the reinvested amount of USD 447,569, and that the entire \$1.7 million was simply forfeited in exchange for the extension of the 1999 JAA. In nominal terms, this would mean that Claimant exchanged \$1.7 million in lost revenue for \$5.4 million in future income.<sup>630</sup> If the forfeited income were adjusted for interest through June 2003,<sup>631</sup> and the future income were discounted at 12.14%,<sup>632</sup> then, Claimant would have exchanged \$1.740 million in lost revenue for \$2.259 million in future revenue, in terms of the net present value of the future income streams as of July 2003.

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<sup>628</sup> Luganova Affidavit, para. 32.

<sup>629</sup> See discussion in section III.G above.

<sup>630</sup> The USD 5.4 million is the sum of the USD 50,000 minimum monthly payment during the extended term of the 1999 JAA from June 30, 2006-June 30, 2015.

<sup>631</sup> The Tribunal has applied the interest rates reflected on page 4 of LECG Exhibit CE-39.

<sup>632</sup> As noted, the 12.14% discount rate is the discount rate Claimant's expert applied in calculating the net present value of Claimant's damages as of 2004. The Tribunal understands that a different discount rate might be appropriate to calculate the net present value of a future income stream as of 2003, but has nevertheless applied the 12.14% rate here for illustrative purposes only.



457. The Tribunal emphasizes that it finds the minimum monthly payment provision under the 1998 JAA inconsistent with Article 1137 of the Civil Code, not because Claimant was able to negotiate an advantageous outcome, but because it insulated Claimant from bearing its share of the joint activity's losses. However, the Tribunal notes that Claimant's ability to negotiate an advantageous outcome derived in large part from the fact that the original payment provisions would have forced the Hotel into a steep loss or exacerbated an existing loss, *i.e.*, from payment provisions that, as of the January 1, 2004 effective date of the Civil Code, should have been void.

**b. 1999 JAA**

458. The issue under the 1999 JAA is less clear, but the Tribunal's conclusion is the same. There is no direct evidence that the joint activity would have experienced a loss under the 1999 JAA even after it made the minimum monthly payments. However, the Tribunal concludes that there is sufficient indirect evidence that this would have been the result. While Claimant's damages expert presented figures showing a net positive cash flow to the Hotel under the 1999 JAA for the period 2001-2015, those figures were derived in large part from the income and cost figures provided in GEYA's Appraisal. While these figures appear to show that the Hotel would experience a net positive cash flow under the 1999 JAA in each year from 2001-2015, they are, in the Tribunal's opinion, misleading.

459. In calculating the projected revenue figures, GEYA accounted for the likely adverse revenue effects resulting from the reconstruction of European Square.<sup>633</sup> However, Ms. Trusova acknowledged in her testimony that the entire adverse revenue effect was allocated to the projected revenue under the 1998 JAA. According to Ms. Trusova:

The appraisal as well as forecasting is a creative activity, and the people who have been doing this forecasting thought it would be sufficient to take into account the negative influence of reconstruction of European Square in determining the long-term financial investment in only one agreement. The result would have been the same. Maybe it will sound a little bit simplistic, but we would split this negative influence between two

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<sup>633</sup> Appraisal Report, Doc. C-149, p. 38.

agreements, but the result of long-term fixed assets investment would have been the same, actually. . . . So, we put everything in one agreement, and nothing in the other.<sup>634</sup>

460. The GEYA Appraisal does not indicate the exact amount of the reduction in the Hotel's income due to the reconstruction of European Square. For example, the Appraisal indicates a fall in income under the 1998 JAA from USD 3,039,000 in 2002 to USD 2,887,000 in 2003, a decline of USD 152,000. The income under the 1998 JAA declined again to USD 2,742,000 in 2004. It is not clear whether the reconstruction of European Square accounts for this entire decline in income or only a portion. In fact, it could be that the fall in income attributable to the reconstruction was greater than USD 152,000 if income would have otherwise increased from 2002 to 2003. For example, if, but for the reconstruction, income under the 1998 JAA would have increased from USD 3,039,000 to USD 3,139,000, the adverse revenue effect attributable to the reconstruction would have been USD 252,000. It is not possible to determine from Claimant's presentation or the GEYA report what the total impact of the reconstruction was estimated to be.

461. Nevertheless, it is likely that, if a portion of the decline in income due to the reconstruction of European Square was allocated to the 1999 JAA – as Ms. Trusova conceded it should have been if GEYA had been more precise in its calculations – the joint activity would have been forced into a loss in 2003 or 2004. The total profits under the 1999 JAA for 2003 were only USD 652,000. Of this amount, USD 600,000 was paid to Alpha under the minimum monthly payment arrangements, leaving only USD 52,000 in revenue for the joint activity. The total profits for 2004 were only USD 679,000. Again, USD 600,000 of this amount was to be paid to Alpha, leaving only USD 79,000 in revenue to the joint activity. It is quite possible, and in the Tribunal's view likely, that the relatively small remaining income that the joint activity received in 2003 and 2004 would have been eliminated if the adverse revenue impact from the European Square reconstruction had been properly recognized. In fact, it could very well have been that the majority of the lost revenue due to the reconstruction of European Square should have been allocated to the 1999 JAA given that revenues under the 1999 JAA were over two and half times as large as revenues under the 1998 JAA.

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<sup>634</sup> Trusova Testimony, Tr. 3, p. 117.

462. The Tribunal, therefore, concludes that the minimum monthly payment provisions under the 1998 and the 1999 JAAs are “invalid” under Article 1137 of the Ukraine Civil Code due to the fact that, in the circumstances described above, they “fully exempt [Claimant] from participation in reimbursement for joint expenses and losses.” The effective date on which the provisions are voided will be discussed below. As of the effective date of the invalidation, Claimant would be entitled only to 50% of the profits of the joint activities.

## **2. Profits**

463. The Tribunal separately concludes that the minimum monthly payment provisions of the 1998 and the 1999 JAAs are void under Article 1139 of the Ukraine Civil Code, which states that a contractual provision “on depriving or refusal of the participant of the right for a part of the profit shall be invalid.”

464. Claimant’s damages expert concedes that, under the 1998 JAA, the Hotel would have experienced a loss each year from 2006-2013, while Claimant would continue to earn USD 600,000 in each of those years.<sup>635</sup> For this entire period, therefore, the Hotel would be deprived of any part of the profits under the 1998 JAA. If the profits had been split evenly, the Hotel would have been profitable in every year between 2001-2015 except 2007.

465. Under the 1999 JAA, according to LECG Exhibit CE-39, the Hotel made a profit in 2003 and 2004. However, as explained in the preceding section, if the decline in revenues attributable to the reconstruction of European Square were properly allocated between the 1998 and the 1999 JAAs, it is likely that the Hotel would have experienced a loss in those years after paying Claimant USD 50,000 per month. The Hotel likely would not have experienced a loss if profits were instead divided evenly. For example, in 2004, the net profits of the joint activity under the 1999 JAA were USD 679,000. If the profits were divided evenly, the Hotel would have earned USD 339,000. Even if losses due to the reconstruction of European Square were properly allocated to the 1999 JAA and then divided between the Hotel and Claimant, it is unlikely that the Hotel’s profit would have been eliminated.

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<sup>635</sup> LECG Supplemental Report, p. 10.

466. Claimant’s damages expert sought to dismiss concerns over the fact that the Hotel would have experienced a loss under the 1998 JAA by urging the Tribunal to consider the two JAAs together. According to the expert, “[a]lthough the 1998 JAA generates slightly negative cash flows to SE Dnipro Hotel, the 1999 JAA profitability compensates for this deficit in the 1998 JAA.”<sup>636</sup> The Tribunal finds this argument unpersuasive. In fact, according to the damages calculation provided by the same expert, the entire “positive cash flow” to the Hotel for the period 2006 through 2014 would have been turned over to Claimant as repayment for the “suspended” payments under the 1998 JAA. For example, in his damages report, Claimant’s expert asserted that the combined 1998 and 1999 JAAs would have had a positive cash flow of USD 244,000 for 2006.<sup>637</sup> Yet, the expert’s damages worksheet in LECG Exhibit CE-39 shows that this same amount would have been dedicated to the “debt payment from Hotel” to Claimant under the 1998 JAA.<sup>638</sup> As a result, when the 1998 and 1999 JAAs are considered together, the Hotel would have had no income whatsoever in 2006. In fact, during the period from 2006 through 2014, and based on the figures Claimant’s expert provided in LECG Exhibit CE-39, the Hotel’s actual total cash flow resulting from the joint activities would have been zero because all cash flows would have been directed to repayment of the suspended 1998 JAA payments (and in some cases, the Hotel would have experienced a loss).

467. The Tribunal recognizes that there are earlier periods during which the Hotel would have experienced a positive cash flow. For example, according to LECG Exhibit CE-39, in 2002, at a time when payments under the 1998 JAA were suspended, the Hotel would have had a positive cash flow of USD 285,000 under the 1998 JAA and USD 28,000 under the 1999 JAA. That same year, Claimant had a positive cash flow of USD 600,000 from income received under the 1999 JAA. The Tribunal further recognizes that, given the suspension of payments under the 1998 JAA, there were periods when the Claimant itself would have received no income under the

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<sup>636</sup> *Id.* at p. 9.

<sup>637</sup> *Id.* at p. 10.

<sup>638</sup> LECG Exhibit CE-39, p. 2. The “Debt Payments” are the payments from the Hotel to Claimant for the monthly amounts that had been suspended under the 1998 JAA from 2004 through July 1, 2006. As Claimant’s expert explained, “[a]s the amendment [regarding the suspension of payments under the 1998 JAA] did not specify how this debt would be repaid, I assume that SE Dnipro Hotel would use its available cash flows from floors 8 to 13, after payment to Claimant, to repay the debt accrued with Claimant during the July 2003 – June 2006 period, from July 1, 2006 onwards.” LECG Report, p. 60.

1998 JAA.<sup>639</sup> However, as explained above, Claimant was amply compensated for this arrangement through the renegotiated terms of the 1998 JAA, and, even during the period of the suspension, Claimant received substantial income under the 1999 JAA.

468. In concept, there is nothing inequitable about a party to a contract striking a bargain in which it trades additional revenue in one year in exchange for foregoing revenue in a future year. However, in this case, the bargain struck resulted in a stretch of nine years in which the Hotel would have received no income whatsoever from the two JAAs combined, and in fact would have been forced into a loss due to the need to bear a proportion of the renovation costs that Claimant's expert projects for 2007 (under the 1998 JAA) and 2009 (under the 1999 JAA). Furthermore, even considering the periods in which the Hotel would have received a net positive cash flow in the early years of the arrangement, the Hotel would have been deprived of any share of the profit at least over the period 2001-2015. Under the terms of the renegotiated agreements, and stated in nominal amounts as set forth in Claimant's expert report, Alpha would receive revenue of approximately USD 16 million for the period 2001-2015, while the Hotel would experience a loss of over USD 1.3 million.<sup>640</sup> In the Tribunal's view, these figures amply demonstrate that the Hotel would, in the words of Article 1139, be "deprived or refused of . . . [its] right for a part of the profit."

469. On this basis, the Tribunal concludes that the minimum monthly payment provisions in the 1998 and the 1999 JAAs are invalid. As of the effective date of the invalidation, Claimant would be entitled only to 50% of the profits of the joint activities.

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<sup>639</sup> See LECG Exhibit CE-39, p. 2.

<sup>640</sup> The Tribunal calculated Claimant's future income stream as the sum of the yearly "cash flow to investor" and "debt payments from Hotel" reported on the worksheet prepared by Claimant's expert. See LECG Exhibit CE-39. The Tribunal calculated the Hotel's income stream as the net profits of the Hotel under both agreements less (1) the payments owed to Claimant under both agreements and (2) the "Debt Payments from Hotel" owed under the 1998 JAA but paid with the proceeds of the 1999 JAA. According to Claimant's expert, the joint activity would experience a loss in 2007 (for the 1998 JAA) and 2009 (for the 1999 JAA) due to renovation expenses. Claimant's expert calculated a total refurbishment cost of USD 2.7 in 2007 and USD 4.2 million in 2009, and assumed that Claimant and Hotel would each pay half the cost. LECG Report, pp. 60-61. These costs are reflected in the Tribunal's calculation of future revenue streams. However, Claimant's expert also assumed that Claimant would receive the minimum monthly payments for these years. For example, while Claimant would be responsible for approximately USD 1.35 million in refurbishment costs for 2007, Claimant's expert reported a net outflow to Claimant of only USD 733,000 (the net of the USD 1.35 million in costs and the USD 600,000 annual payment to Claimant). LECG Exhibit CE-39, p. 2.

### 3. Effective Date of Invalidation of Minimum Monthly Payments

470. While the Tribunal agrees with Respondent that the minimum monthly payment provisions in the two agreements are void, neither Respondent nor its expert provided a convincing legal ground for voiding the provisions *ab initio*. The Tribunal notes, for example, that Mr. Bozhenko had concluded that the terms of the contracts were permissible at the time he drafted the agreements.<sup>641</sup> Furthermore, the Tribunal's finding that the minimum payment provisions are invalid is based on Articles 1137 and 1139 of the Ukraine Civil Code which, as noted above, did not enter into force until January 1, 2004. At the time the contracts were drafted until 2004, the contracts were governed by the USSR Civil Code, which did not contain restrictions similar to those in the Ukraine Civil Code. Respondent has not demonstrated that the minimum monthly payment provisions were invalid under the USSR Civil Code, nor has it demonstrated or even argued that the Ukraine Civil Code has retroactive effect. Consequently, the Tribunal finds no basis for voiding the minimum monthly payment provisions *ab initio*.

471. The Tribunal concludes that the minimum monthly payment provisions should be voided at the earliest time after January 1, 2004 – when the Ukraine Civil Code entered into force – when the minimum payments either (1) would have been made despite the fact that the joint activity experienced a loss or when the payments would have resulted in a loss or (2) would have deprived the Hotel of any share of the profits. For the reasons described below, the Tribunal concludes that such circumstances existed well before January 1, 2004, and continued after that date. Consequently, the Tribunal has decided to void the provisions as of January 1, 2004.

472. With respect to the 1998 JAA, this situation was apparent at the time the parties renegotiated the agreement on September 1, 2000. It was then that the parties concluded that the monthly payments would need to be suspended because the Hotel could not afford to make the needed expenditure to upgrade the Hotel on its own. At a minimum, the situation was evident in 2003, when GEYA completed its Appraisal, as the Appraisal included the basic revenue projections which formed the basis of Claimant's expert report, which in turn was the basis for the Tribunal's preceding analysis of the allocation of losses and profits. The parties were

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<sup>641</sup> See Bozhenko Affidavit. See also Rozenblit opinion, Doc. R-16 (regarding the 1996 JAA).

certainly aware of this situation when the Ukraine Civil Code entered into force on January 1, 2004. Therefore, the Tribunal has decided to reform the terms of the 1998 JAA as of that date.

473. With respect to the 1999 JAA, it is not possible to determine with precision when a loss would have occurred due to the ambiguities in the GEYA Appraisal noted above with respect to the costs associated with reconstruction of the European Square. The Tribunal concludes that a loss would likely have occurred in 2003 or 2004 if the costs were allocated properly. If, as Claimant's expert urges the Tribunal to do, the 1998 and 1999 JAAs are considered together, it was also clear that, as of the date the 1999 JAA was extended on August 29, 2003, the Hotel would receive no profit under the agreement but would instead be required to allocate its entire positive cash flow to servicing the 1998 JAA. The parties were likely aware of this fact given that the GEYA Appraisal was completed in mid-2003. Therefore, as with the 1998 JAA, the Tribunal has decided to reform the terms of the 1999 JAA as of January 1, 2004.

474. In summary, the Tribunal concludes that profits and expenses under the respective agreements should have been distributed on a 50/50 basis as specified in the contracts, beginning from January 1, 2004.

475. The Tribunal must address one final point with respect to the renegotiated contracts. While the Tribunal recognizes that the extensions of the 1998 JAA and 1999 JAA appear to have resulted from renegotiations forced by the Hotel's potential losses, the Tribunal cannot conclude on the basis of the record that the extensions (as opposed to the minimum monthly payments) are themselves invalid. Indeed, Respondent has provided no legal argumentation that would compel the Tribunal to void the extensions. On the other hand, the record contains evidence that the parties had embarked on a long-term commercial relationship, and it is quite possible that they would have extended the terms of the agreements in any case, albeit with a different payment structure. Mr. Tsybuch wrote, for example, that "at that time the State Enterprise 'Hotel Dnipro' as well as the State Tourist Administration, which I at that time headed, were reckoning on further continuation of the joint activity with 'Alpha Projektholding' GmbH in view of the existing reconstruction as well as construction of a new hotel at the territory of 'Hotel

Dnipro.”<sup>642</sup> The Tribunal refuses to speculate in this regard, and will, therefore, allow the extensions to stand, but with the 50/50 terms discussed above.

## **IX. Damages**

### **A. The Positions of the Parties**

476. In its Memorial, Claimant claimed damages in the amount of USD 10,085,000, expressed in terms of net present value (NPV) as of 2004. Accounting for interest at a 12 month LIBOR rate through February 2009, Claimant’s initial damages claim totaled approximately USD 12,100,000. The analysis underlying the claim was set forth in the June 29, 2008, report prepared by Marcelo Schoeters of LECG, LLC, entitled “Loss Assessment for Alpha Projektholding GmbH.” In its Reply, Claimant presented a revised damages claim of USD 9.467 million, expressed in 2004 NPV. The revised damages claim reflected new information indicating that certain outstanding payments preceding the stop in payments in 2004, and included in Claimant’s original damages claim, had in fact been paid. Including interest through February 1, 2009, the revised claim totaled USD 11.4 million.<sup>643</sup> The analysis underlying the revised claim was set forth in the November 26, 2008, Supplemental Report prepared by Mr. Schoeters. Respondent presented two reports prepared by the consulting firm EBS in response to the LECG reports. The first EBS report is dated September 29, 2008, and the second is dated January 20, 2009.

477. Claimant’s revised damages claim is composed of the following elements, expressed in terms of 2004 NPV:

- “Historical losses” of USD 371,000: This total includes three outstanding payments under the 1998 JAA covering the period June-August 2000, and five outstanding payments under the 1999 JAA covering the period February-June 2004.
- “Foregone income” of USD 6.529 million: This total reflects the total income Claimant would have received under the 1998 and 1999 JAAs covering the period 2004-2015. The total was calculated as (1) the sum of the expected payments of USD 50,000 per month under each agreement; (2) an additional amount reflecting the repayment of the suspended payments under the 1998 JAA; and (3) a

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<sup>642</sup> Tsybuch Letter, p. 2.

<sup>643</sup> Reply, p. 24.



deduction for a portion of the estimated costs related to renovation of the Hotel in 2007 and 2009.

- “Terminal value of the joint activity” of USD 2.567 million: This total reflects LECG’s estimate of half of the going concern value of floors 11-12 under the 1998 JAA and floors 8-10 under the 1999 JAA.

478. The annual income, expense and other payment figures underlying these totals are set forth in a spreadsheet submitted as Exhibit CE-39 to LECG’s Supplemental Report. In calculating the 2004 NPV of the components of the damages claim, LECG calculated and applied a discount rate of 12.14%, and, in updating the “historical losses” to 2004, the annual LIBOR rate, *i.e.*, the average 12-month LIBOR rate for each month of the year was used. LECG also applied the annual LIBOR rate in updating the damages total through February 2009.

479. Respondent’s expert, EBS, largely agreed with LECG’s methodology, though it reiterated several of the objections raised by Respondent during the course of the argumentation on the merits, *e.g.*, that the minimum monthly payment requirement was invalid, that the contracts did not constitute legitimate joint activities, etc. The Tribunal has dealt with those substantive objections above. EBS also argued that Claimant was not entitled to any terminal value because the improvements belonged to the Hotel,<sup>644</sup> and took issue with LECG’s proposed discount rate. EBS proposed an alternative discount rate of 14.42%, which was based on EBS’s assessment of the debt-equity ratio of the joint activity as opposed to the Hotel as a whole.<sup>645</sup>

480. After dealing with certain preliminary issues, the Tribunal shall examine each of the three components of LECG’s damages calculation in turn, taking into account the Tribunal’s previous findings on the facts and merits.

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<sup>644</sup> EBS Expertise Services Prepared for the Ministry of Justice of Ukraine in Respect of Loss Assessment for Alpha Projektholding GmbH Prepared by Marcelo A. Schoeters (September 29, 2008) (“EBS Report”), p. 8.

<sup>645</sup> According to EBS, LECG “considers equity to debt ratio of the SE Dnipro Hotel. While the calculation of the WACC [weighted average cost of capital] is performed more or less correctly, we cannot agree with it conceptually. . . . [W]e believe that it would be correct to apply debt to equity ratio for the agreement, which has ‘its own’ assets but not for SE Dnipro Hotel. In the specific situation it would have been 100% equity, instead of 60% equity ratio applied which would bring WACC to 14.42% instead of 12.1% applied.” EBS Report, p. 11. EBS also took issue with LECG’s reliance on an estimated 10% growth in revenue given, for example, limited occupancy capacity. EBS Report, p. 14. LECG responded to this concern at length, and explained that its position was grounded, for example, in trends in foreign visitors to Ukraine. LECG Supplemental Report, pp. 15-16. The Tribunal finds LECG’s analysis persuasive.

## **B. The Tribunal's Findings**

### **1. Date on Which Ukraine Violated Its BIT Obligations**

481. Claimant has asserted that the effective date of the expropriation of its investments was July 1, 2004, *i.e.*, the first day of the month after Claimant received its last payment. The Tribunal agrees that this is the date on which the expropriation occurred. While, as discussed above, subsequent actions of the Ukrainian government perpetuated the non-payment to Claimant, the expropriation (and other BIT violations) occurred at the time the payments ceased, never to be resumed.

### **2. Discount Rate**

482. As noted, LECG proposed using a discount rate of 12.14% in order to determine the NPV of the future revenue streams and terminal values as of 2004.<sup>646</sup> The 12.14% figure represented the weighted average cost of capital (WACC) based on the debt-to-equity ratio of the Hotels & Motels category for emerging markets reported in Bloomberg.<sup>647</sup> In response, EBS asserted that “it would not be correct to apply debt to equity for the agreement, which has ‘its own’ assets but not for the SE Dnipro Hotel. In this specific situation it would have been 100% equity, instead of 60% equity ratio applied which would bring WACC to 14.42% instead of 12.1% applied.”<sup>648</sup> LECG cited several authorities in support of the proposition that “the target capital structure must be used, instead of that of the actual firms being valued.”<sup>649</sup>

483. The Tribunal finds LECG’s justification for a discount rate of 12.14% persuasive and will apply that rate in calculating appropriate damages, as discussed below.

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<sup>646</sup> LECG’s explanation of its proposed discount rate is provided in LECG’s June 29, 2008, Report at pp. 72-80 and LECG’s November 26, 2008, Supplemental Report at pp. 21-22.

<sup>647</sup> LECG Supplemental Report, p. 22.

<sup>648</sup> EBS Report, p. 11.

<sup>649</sup> LECG Supplemental Report, p. 22, n. 60.

### 3. Analysis of Components of Claimant's Damages Claim

#### a. Historical Losses

484. As noted, LECG calculated the 2004 NPV of the outstanding payments owed to Claimant prior to July 1, 2004, as USD 371,000. The missing payments are documented in Doc. C-203. As there is no prospect that these payments will be made due to the actions of the Ukrainian government described in the merits section above, the Tribunal concludes that this outstanding debt constitutes part of Claimant's damages for which compensation is owed.

485. The three outstanding payments under the 1998 JAA covered June, July and August 2000, and were for USD 35,000 each, *i.e.*, the minimum monthly payment due under the original 1998 JAA. As discussed above, the Tribunal has concluded that the minimum monthly payment provision in the 1998 JAA was void as of January 1, 2004. As the outstanding payments covered periods preceding the voidance of the minimum payment term, the Tribunal concludes that the claimed amounts are properly included in the damages calculation in their entirety. Claimant is entitled to repayment of these amounts, totaling USD 105,000 in nominal terms. The 2004 NPV of the payments, after adjustments based on annual LIBOR rates, is **USD 117,421**.

486. The five outstanding payments under the 1999 JAA covered February-June 2004, and were for USD 50,000 each, *i.e.*, the minimum monthly payment due under the 1999 JAA. As the outstanding payments covered periods after the voidance of the minimum payment provision as of January 1, 2004, the Tribunal concludes that the claimed amounts must be adjusted, and should equal 50% of the profits of the joint activity during the relevant periods. According to the spreadsheet provided in Exhibit CE-39 to LECG's Supplemental Report, the total net profits of the joint activity under the 1999 JAA during 2004 was USD 679,000. Claimant was entitled to one-half of this amount, or USD 339,500. Spread equally over the year, Claimant would be entitled to USD 28,292 per month.<sup>650</sup> For the five months covering February-June 2004, Claimant is entitled to **USD 142,204**, expressed in terms of the 2004 NPV.

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<sup>650</sup> The record does not contain adequate information to calculate the actual monthly profits of the joint activity.

**b. Foregone Income**

**(i) Arguments of the Parties**

487. LECG included in its damages calculation USD 3.637 million of foregone revenue under the 1998 JAA and USD 2.892 million of foregone revenue under the 1999 JAA, expressed in terms of 2004 NPV. The foregone revenue under the 1998 JAA is calculated as the sum of the expected USD 50,000/month payments during the period July 2006-June 2015 plus specified amounts designated as “debt repayment,” *i.e.*, repayment of the payments that had been suspended during the period July 2003-June 2006. The foregone revenues under the 1999 JAA are calculated as the sum of the expected USD 50,000/month payments during the period from July 2004-June 2015. Claimant has also deducted amounts related to estimated renovation costs in 2007 related to floors 11-12 (under the 1998 JAA), and for renovation costs in 2009 related to floors 8-10 (under the 1999 JAA). For reasons discussed above, Respondent and EBS argued that Claimant was not entitled to the minimum monthly payments under the 1998 or 1999 JAAs.

**(ii) Tribunal’s Findings**

488. The Tribunal shall deal, first, with the revenue foregone due to the failure to make the monthly payments to Claimant and, second, with the revenue foregone due to the lost debt repayments.

**(a) Revenue Foregone Due to Failure to Make Monthly Payments**

489. As discussed above, the Tribunal has concluded that the minimum monthly payment provisions under the 1998 and 1999 JAAs are void as of January 1, 2004. Therefore, from that date onward, Claimant was entitled to 50% of the profits of the joint activities and not the minimum monthly payments specified in the contracts. In calculating the amount owed to Claimant, the Tribunal used the “50% of Net Profits” figures reported on pages 2 and 3 of the LECG spreadsheet provided in Exhibit CE-39 to LECG’s Supplemental Report.

490. Under the 1998 JAA, monthly payments to Claimant were to resume in July 2006 and to continue through July 1, 2015. Claimant is entitled to damages in the amount of 50% of the profits of the joint activity during this time. The Tribunal calculated the total by summing up the

figures appearing in the “50% of Net Profits” line on page 2 of Exhibit CE-39 for the period 2006-2015, with certain adjustments. The components of the total were calculated as follows:

- For the half years in 2006 and 2015, the Tribunal apportioned the profit evenly over the year. According to Exhibit CE-39, LECG estimated that 50% of the net profits in 2006 under the 1998 JAA would have been USD 133,000. Allocated evenly over the year, the profit owed to Claimant for the period July 2006-December 2006 would be half of this amount, or USD 66,500. According to Exhibit CE-39, LECG estimated that 50% of the net profits in 2015 under the 1998 JAA would have been USD 339,000. Allocated evenly over the year, the profit owed to Claimant for the period January 2015-June 2015 would be half of this amount, or USD 169,500.
- Following Claimant’s methodology, the Tribunal deducted from the foregone revenue figures under the 1998 JAA half of the renovation costs that LECG estimated for 2007. LECG estimated that the Claimant’s share of the renovation costs would be USD 1.33 million,<sup>651</sup> and estimated that 50% of the profits that year would total USD 148,000.<sup>652</sup> Thus, in nominal terms, Claimant would have experienced a loss of USD 1.185 million in 2007 under the 1998 JAA.
- According to Exhibit CE-39, LECG estimated that 50% of the net profits for the years 2008-2014 would total, in nominal terms, USD 1.614 million.

491. Based on these calculations, and applying LECG’s proposed discount rate of 12.14%, the Tribunal has determined that Claimant could have expected to experience a **loss** under the 1998 JAA for the period July 2006-June 2015 of **USD 26,249**, expressed in terms of July 2004 NPV.

492. Monthly payments were never suspended under the 1999 JAA. Therefore, Claimant was entitled to monthly payments under the 1999 JAA from the stop in payments in July 2004 until June 30, 2015. As explained, Claimant is entitled to monthly payments in an amount equal to 50% of the profits of the JAA, not the specified minimum payments of USD 50,000 per month. The Tribunal calculated the revenue foregone under the 1999 JAA as the sum of the figures reported in the “50% of Net Profits” line on page 3 of Exhibit CE-39 for the years 2004-2015, with certain adjustments. The components of the total were calculated as follows:

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<sup>651</sup> LECG Report, p. 61 (“The final refurbishment costs applied are US\$ 2.7 million in 2007 and US\$ 4.2 million in 2009 for floors 11-13 and floors 8-10, respectively . . . I assume that the capital needed for the refurbishments is contributed by Claimant and the SE Dnipro Hotel on a 50-50 basis.”) A more precise estimate appears in LECG Exhibit CE-39, p. 2. There, LECG estimated that Claimant would be paid USD 600,000 in 2007 but would experience a loss of USD 733,000 that year, due to the fact that it would need to pay USD 1.33 million in refurbishment costs.

<sup>652</sup> LECG Supplemental Report, p. 2.

- For the half years in 2004 and 2015, the Tribunal apportioned the profit evenly over the year. According to Exhibit CE-39, LECG estimated that 50% of the net profits in 2004 under the 1999 JAA would have been USD 339,000. Allocated evenly over the year, the profit owed to Claimant for the period July 2004-December 2004 would be half of this amount, or USD 169,500. According to Exhibit CE-39, LECG estimated that 50% of the net profits in 2015 under the 1999 JAA would have been USD 1.016 million. Allocated evenly over the year, the profit owed to Claimant for the period January 2015-June 2015 would be half of this amount, or USD 508,000.
- Following Claimant's methodology, the Tribunal deducted from the foregone revenue under the 1999 JAA half of the renovation costs that LECG estimated for 2009. LECG estimated that the Claimant's share of the renovation costs would be USD 2.109 million,<sup>653</sup> and estimated that 50% of the profits that year would total USD 594,000.<sup>654</sup> Thus, in nominal terms, Claimant would have experienced a loss of USD 1.515 million.
- According to Exhibit CE-39, LECG estimated that 50% of the net profits for the years 2005-2008 and 2010-2014 would total, in nominal terms, USD 5.597 million.

493. Based on these calculations, and applying LECG's proposed discount rate of 12.14%, the Tribunal has determined Claimant could have expected to be paid **USD 2,209,822** under the 1999 JAA for the period July 2004-June 2015, expressed in terms of July 2004 NPV.

(b) **Debt Repayment Related to Suspended Payments Under the 1998 JAA**

494. Claimant included in its damages claim an amount related to the repayment of the payments that had been suspended under the 1998 JAA during the period July 2003-June 2006. LECG provided the following explanation:

The amendment [to the 1998 JAA] stipulated that the payments must be updated to the time of payment by a 'non-risk rate on banking credits in currency for legal persons in Ukraine and interest of additional risks on capital with works in Ukraine.' As the amendment does not specify how this debt would be repaid, I assume that SE Dnipro Hotel would use its available cash flows from floors 8-13, after payment to Claimant, to

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<sup>653</sup> LECG estimated the total refurbishment costs related to floors 8-10 in 2009 to be USD 4.2 million, of which Claimant would pay USD 2.1 million. LECG's Report, p. 61. The more precise figure of USD 2.109 million can be derived from the figures on page 3 of LECG Exhibit CE-39, which show a net negative cash flow to Claimant under the 1999 JAA in 2009 of USD 1.509 million. Claimant's total outlays for refurbishment include this amount plus the USD 600,000 payment from the Hotel, for a total of USD 2.109 million.

<sup>654</sup> LECG Supplemental Report, p. 2.

repay the debt accrued with Claimant during the July 2003-June 2006 period, from July 1, 2006 onwards.<sup>655</sup>

495. LECG did not provide its precise calculation, and did not specify in its discussion of the debt repayment the actual interest rate that it applied. EBS noted this lack of clarity.<sup>656</sup> For this reason, in calculating the amounts owed as of 2006, the Tribunal is unable to determine the appropriate interest rate as specified in the contract. Consequently, the Tribunal will use the annual LIBOR rate as discussed below.

496. The Tribunal has already determined that any damages under the 1998 JAA that were incurred after January 1, 2004, should be calculated on the basis that Claimant was entitled to 50% of the net profits of the joint activity. On this basis, and using the “50% of Net Profits” figures reported on page 2 of Exhibit CE-39 of LECG’s Supplemental Report, the Tribunal determines that, in nominal terms, Claimant is owed USD 300,000 for July-December 2003<sup>657</sup>; USD 126,000 for 2004; USD 131,000 for 2005; and USD 66,500 for January-June 2006.<sup>658</sup>

497. Applying the annual LIBOR rate, the total of these payments as of July 2006 (when the suspension period would end and the payments would be due) would be USD 675,645. Applying a discount rate of 12.14%, the July 2004 NPV of these payments is **USD 523,151**.

### **c. Terminal Value**

#### **(i) Position of Claimant**

498. Article 6.4 of the 1998 JAA states that, upon termination of the contract, “the funds and the property shall be divided between the Parties proportionally to their investment after reimbursement of all debts resulting from the joint activities under the established procedures.” Similarly, Article 6.6 of the 1999 JAA states that, upon termination of the contract, “the assets and property are to be distributed between the PARTIES pro rata to their contributions into joint activities, after reimbursement made by the PARTIES according to the established order of debts

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<sup>655</sup> LECG Report, p. 60.

<sup>656</sup> EBS Supplemental Loss Assessment Report, January 20, 2009, pp. 3-4 (“EBS Supplemental Report”).

<sup>657</sup> As this period was prior to the reformation of the contract as of January 1, 2004, this figure reflects monthly payments of USD 50,000.

<sup>658</sup> In calculating the profit for the half years in 2003 and 2006, the Tribunal allocated the annual profits evenly over the year.

remaining after the carrying out of joint activities.” Both contracts indicated that the contributions of Claimant and the Hotel were virtually equal.

499. On the basis of these contractual provisions, LECG concluded that “Claimant was entitled to receive half of the terminal value of the joint activity, calculated as the perpetuity of the cash flows as of 2015 onwards.”<sup>659</sup> LECG, therefore, included in its damages calculation half of the estimated terminal value for floors 11-12 under the 1998 JAA and half of the estimated terminal value for floors 8-10 under the 1999 JAA. Expressed in terms of 2004 NPV, LECG calculated the total damages related to the terminal value of the joint activities as USD 2.567 million.

500. EBS raised three objections to Claimant’s claim for a portion of the “terminal value” of the assets.<sup>660</sup> First, EBS asserted that the underlying property did not belong to the joint activities and that, therefore, the value of the physical assets must not be included in the terminal value of the joint activities’ assets. Second, the value of the improvements would have to be amortized over several years. The thrust of EBS’s argument on this point appears to be that, even if the improvements constituted assets of the joint activities, their value would be substantially diminished or eliminated entirely by the time the contracts terminated. Finally, EBS argued that the LECG estimate improperly included the expected cash flow to be derived from the floors as a whole, and not the portion of the revenues attributable only to the improvements.

#### **(ii) Tribunal’s Findings**

501. The Tribunal does not accept the assumption that the entire going concern value of the floors would constitute assets of the joint activities upon termination of the contracts. Ownership of the floors was, and always has been, vested in the Hotel. Furthermore, while the Hotel contributed the right to use the floors for the periods specified in the contracts, that right would no longer exist once the contracts ended and could not constitute an asset of the joint activity.

502. The only asset that would arguably belong to the joint activities upon termination of the contracts would be the improvements that were made as a result of the joint activities. Even

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<sup>659</sup> LECG Report, p. 61.

<sup>660</sup> EBS Supplemental Report.



then, however, the joint activities would only have rights with respect to the improvements made under the 1998 JAA, not under the 1999 JAA. As explained in section VII.B.1.b above, both the original 1999 JAA and Additional Agreement No. 1 to the 1999 JAA specified that the improvements made under the JAA were to revert to the Hotel. As a result, the joint activity would have no remaining rights in those improvements. Therefore, the Tribunal concludes that the only asset of the joint activities upon termination of the contracts would be the improvements made under the 1998 JAA.

503. EBS argued that the improvements would be fully depreciated and would have little or no value by the end of the contracts in 2015. However, neither Respondent nor EBS provided any evidence to this effect and did not present any analysis of appropriate depreciation rates. Consequently, the Tribunal has no basis for assuming that the improvements would have no value as of 2015. On the other hand, Claimant did not provide any estimate of the value (as opposed to the cost) of the improvements or of the extent to which the improvements contributed to the value of the floors. The Tribunal is, therefore, left to glean this information from the record.

504. The Tribunal notes that the GEYA Appraisal included an estimate of the net annual income to be derived from each floor of the Hotel, from the basement through the 12<sup>th</sup> floor. According to the Appraisal:

[T]he spaces which may be leased out have their own characteristics: different functional purpose and not identical physical state. In particular, the spaces on 4-7 stories need immediate repairs and do not meet modern standards of accommodation of hotels of 4-star class and the spaces on 8-12 stories were repaired and upgraded in 1996-2000. Those factors along with local disposition of rooms in the building (basement, dress-circle, first story, second story etc) determine different investment potentials and as a result, different rentals for such spaces.<sup>661</sup>

505. After providing an estimate of the income to be derived from each floor, GEYA estimated that “the spaces on 8-12 stories possess a greater investment potential by 10% when compared with the 1-7 stories.”<sup>662</sup> On this basis, the Tribunal concludes that the value of the improvements completed under the 1998 JAA accounted for 10% of the value of floors 11-12.

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<sup>661</sup> GEYA Appraisal, Doc. C-149, p. 30.

<sup>662</sup> *Id.*

The terminal value of the assets of the joint activity under the 1998 JAA, *i.e.*, the improvements, should therefore be calculated as 10% of the going concern value of the floors.

506. In nominal terms, LECG calculated the terminal value of floors 11-12 to be USD 2.456 million.<sup>663</sup> EBS agrees that LECG's methodology was technically correct.<sup>664</sup> The Tribunal will, therefore, accept this value of the going concern value of the floors as a whole. The value of the improvements would be 10% of this amount, or USD 245,600. Claimant is entitled to half of this amount, or USD 122,800 in nominal terms. Applying a discount rate of 12.14%, and expressed in terms of July 2004 NPV, Claimant is entitled to **USD 34,820** for the terminal value of the improvements made under the 1998 JAA.

507. While the Tribunal has decided to award Claimant half of the terminal value of the improvements made under the 1998 JAA, it does so reluctantly. The contracts state, and Claimant argues, that the assets of the joint activity are to be divided in proportion to the parties' contributions. Under the terms of the original contracts, the parties' contributions were equal; hence the 50/50 division of the value of the improvements. However, it is clear that, due to the various renegotiations, the parties' contributions were significantly different than those stated in the original contracts. For example, the Hotel's contribution under the 1998 JAA was the right to use floors 11-12 until July 1, 2004, and the Hotel's contribution under the 1999 JAA was the right to use floors 8-10 until June 31, 2006. The terms of both contracts were extended until 2015, thus substantially expanding the "right to use" the floors and materially increasing the Hotel's contributions.

508. The Tribunal recognizes that Claimant's contribution was also increased due to the suspension of payments and reinvestment under the 1998 JAA. However, as discussed above, the renegotiations that resulted in the suspension and the reinvestment were not balanced. In fact, the renegotiation resulted in Claimant being owed far more than it conceivably contributed, so much so that the Hotel was effectively stripped of all revenue. Claimant did not provide any argumentation or analysis of the parties' relative contributions once the renegotiations took place. However, neither did Respondent, and it would be pure speculation for the Tribunal to assess with precision, based on the record, what the parties' actual relative contributions were.

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<sup>663</sup> See LECG Exhibit CR-32, p. 2.

<sup>664</sup> EBS Supplemental Report, p. 4.

Consequently, the Tribunal is left with no choice but to divide the value of the improvements under the 1998 JAA evenly between the parties.

#### **4. Adjustment for Overpayment Under the 1999 JAA**

509. As explained above, the Tribunal has decided that the minimum monthly payment provision under the 1999 JAA was void as of January 1, 2004. From that point forward, Claimant was entitled to 50% of the profits of the joint activity, not the USD 50,000 minimum monthly payments. However, the Hotel made the minimum monthly payment for January 2004.<sup>665</sup> Claimant's damages must be adjusted to deduct the overpayment, *i.e.*, the amount by which the payment exceeded 50% of the joint activity profits.

510. According to LECG Exhibit CE-39, the joint activity's profit in 2004 was USD 679,000, which, when spread evenly over the year, amounts to USD 56,583 per month, of which, Claimant was entitled to USD 28,292. Claimant in fact received USD 50,000 as payment for January. Adjusted for interest, the difference between (1) the minimum monthly payments and (2) 50% of the profits during those months is **USD 21,937**. The Tribunal will deduct this amount from Claimant's total damages.

#### **5. Return of Original Contribution**

511. The Tribunal notes that Claimant's legal expert, Professor Omelchenko, asserted repeatedly during the course of the arbitration that the parties to a joint activity are entitled to the return of their original contribution. However, the damages figures that Claimant presented do not include any claim for return of Claimant's original contribution, and Claimant has not provided sufficient evidence or argumentation to determine how any such amount should be determined. As noted, neither Claimant nor Respondent offered any alternative calculation for the parties' relative contributions once the various renegotiations had taken place, and neither Claimant nor Respondent addressed how, for example, the Hotel's "contribution" would be returned given that it contributed the right to use the floors for a specified period of time.

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<sup>665</sup> See Doc. C-203. The January payment was not received by Claimant until June. It was the last payment that Claimant received.

512. For these reasons, the Tribunal neither grants any amount to Claimant for its original contribution nor offsets Claimant's damages for the return of the Hotel's contribution.

**C. Conclusion Regarding Damages**

513. On the basis of the foregoing, the total damages owed to Claimant, expressed in terms of 2004 NPV, are as follows:

Historical losses under the 1998 JAA	USD 117,421
Historical losses under the 1999 JAA	USD 142,204
Revenue foregone under the 1998 JAA	(USD 26,249)
Revenue foregone under the 1999 JAA	USD 2,209,822
Debt payments related to the suspended payments under the 1998 JAA	USD 523,151
Terminal value	USD 34,820
Adjustment for Overpayment under 1999 JAA	(USD 21,937)
<b>TOTAL AS OF 2004</b>	<b>USD 2,979,232</b>

514. In calculating interest to update the damages claim to February 2009, Claimant's damages expert applied the 12 month LIBOR rate, compounded annually. The Tribunal concludes that a more appropriate rate is the risk-free rate<sup>666</sup> plus the market risk premium,

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<sup>666</sup> In determining the risk-free rate, Claimant's expert chose to use the rate for ten-year U.S. Treasury bonds given that, among the various available options, the ten year maturity most closely matched the duration of the cash flows

which, according to LECG Exhibit CE-39, is 9.11% in total. The Tribunal believes that this rate better reflects the opportunity cost associated with Claimant's losses, adjusted for the risks of investing in Ukraine. Applying this rate, compounded annually, the total damages owed to Claimant as of December 31, 2010 is **USD 5,250,782**.

## **X. Arbitration Costs and Legal Fees**

515. Each party shall bear its own legal fees and expenses.

516. Each party is responsible for half of the total arbitration costs, with one adjustment. As discussed above, during the course of the proceeding, the Respondent proposed the disqualification of Dr. Yoram Turbowicz. The two other members of the Tribunal dismissed the challenge. In the view of the two members of the Tribunal who decided the challenge, it is appropriate for Respondent to bear the arbitration costs associated with the challenge. The total arbitration costs relating to the challenge are **USD 60,000**. It is therefore appropriate for Respondent to cover **USD 30,000**, which is Claimant's share of those costs.

## **XI. Conclusion**

517. On the basis of the foregoing, the Tribunal finds as follows:

- Respondent has expropriated Claimant's rights and interests in the 1998 and 1999 JAAs in violation of Article 4 of the UABIT;
- Respondent has denied fair and equitable to Claimant's investments in violation of Article 2 of the UABIT;
- Respondent has not violated Article 8 of the UABIT with respect to Claimant's investments;
- Respondent has not violated the national treatment obligation in Article 3 of the UABIT with respect to Claimant's investments; and
- Respondent has not violated the FIL with respect to Claimant's investments.

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being valued. LECG Report, p. 73. As explained by LECG, other options included the rate for U.S. Treasury bills or the rate for 30-year U.S. Treasury bonds. Respondent's expert did not contest this approach.

518. Respondent is hereby ordered to pay **USD 2,979,232** with additional interest accruing from July 1, 2004, at a rate of 9.11 percent compounded annually. As stated above, if payment were made on December 31, 2010, total damages owing as of that date would be **USD 5,250,782**.

519. Each party shall bear its own legal fees and expenses. Each party is also responsible for half of the total arbitration costs, with the adjustment that **USD 30,000** of Claimant's costs shall be shifted to Respondent.

/ signed /

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Hon. Davis R. Robinson, Chairman  
Date: October 20, 2010

/ signed /

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Dr. Stanimir A. Alexandrov  
Date: 20/10/2010

/ signed /

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Dr. Yoram Turbowicz  
Date: 20/10/2010