



School of International Arbitration

School of International Arbitration, Queen Mary, University of London

International Arbitration Case Law

*Academic Directors: Ignacio Torterola
Loukas Mistelis**

BOSH INTERNATIONAL, INC AND B & P LTD FOREIGN INVESTMENT ENTERPRISES V. UKRAINE

Case Report by Josel N. Mostajo**
Edited by Ignacio Torterola***

An Award rendered on October 25, 2012, in accordance with ICSID Convention and Arbitration Rules.

Tribunal: Dr. Gavan Griffith, QC (President), Professor Philippe Sands, QC (Arbitrator), Professor Donald McRae (Arbitrator)

Claimant's Counsel: Dr. Todd Weiler, Ms. Martha Harrison, Heenan Blaikie, LLP

Respondent's Counsel: Ms. Larysa Lischynska, Acting Head of Department, Department on Representation of Interests of the State in Courts of Ukraine and in Foreign Judicial Institutions, Ministry of Justice, Mr John Willems, Mr Michael Polkinghorne, Ms Marily Paralika, and Ms Angélica André, of White & Case LLP, Paris, France, Mr Markiyany Kliuchkovskyyi, Mr Serhii Sviriba, and Ms Olena Koltko, of Magisters (subsequently known as Egorov Puginsky Afanasiev & Partners)

* Directors can be reached by email at ignacio.torterola@internationalarbitrationcaselaw.com and loukas.mistelis@internationalarbitrationcaselaw.com

** Josel N. Mostajo is currently pursuing his LLM at the University of Notre Dame in Indiana. He is on academic leave from his post as Director IV of the Office of the President of the Philippines for AY 2012-2013.

*** Ignacio Torterola is co-Director of International Arbitration Case Law (IACL).

Digest

1. Facts of the Case

1. The Claimants are Bosh International, Inc ('Bosh') and B&P Ltd Foreign Investments Enterprise ('B&P'). The first Claimant, Bosh, was incorporated under the laws of New Jersey, United States of America. The second Claimant, B&P, was incorporated under the laws of Ukraine in May 1993. Bosh claims to hold a 94.5% shareholding in B&P. The founder and owner of Bosh is Mr. Leonis Shapsis, who owns 100% of the shares in Bosh. Mr. Shapsis became a permanent resident of the United States in 1989 and acquired United States citizenship in 1995. The Respondent is the Ukraine.

2. The owner of Bosh, Mr. Shapsis, established Bosh in 1992 in order to operate a construction firm in Ukraine to take advantage of the opportunities that Ukraine's newly achieved independence from the Soviet Union would provide for business. Mr. Shapsis also enlisted the collaboration of Mr. Borys Boguslavskyy, who was living in Ukraine and who became the President of B&P.

3. B&P had first become involved with the Taras Shevchenko National University of Kiev ("University") when it was engaged to perform some repair works of the latter's building located in 3 Chervonozorianski Avenue. The University was founded in 1833, it is a 'multidisciplinary education and scientific complex' and consists of '15 faculties and six institutes', and employs around 2,000 academic staff.

4. After the completion of this repair work, the City of Kiev decided to upgrade and renovate a city square close to the property at 3 Chervonozorianski Avenue, and in the context of those works, the City of Kiev and the University discussed the future of the property. At the time, a large part of the property was in a state of disrepair, and was partially occupied by squatters. It was designated as a

dormitory for students at the University, but it was used for other purposes due to its inconvenient location for the University. It was decided that a facility should be developed comprising a hotel, research training center with conference and meeting rooms, dining facility, a garden and sporting facility which would be capable of holding academic symposia, seminars and conferences.

5. The University contacted B&P to enquire as to its interest in undertaking the redevelopment project. The University recognized that it did not have the funds to finance the redevelopment, and that B&P would have to contribute capital and other resources to carry out the redevelopment project, and that in return, B&P would own a 50% share of the project for 25 years.

6. B&P and the University then entered into negotiations and after several meetings with the concerned university officials, they entered into a contract on 29 January 2003, known as Contract 07-03-02' for the redevelopment of the property ("the 2003 Contract"). The subject of the 2003 Contract was the creation of the joint venture between B&P and the University to redevelop and operate the Science-Hotel Complex. The joint venture was to be an unincorporated joint venture, or a "joint activity without the creation of a legal entity partnership", as it is known in Ukrainian law.

7. The contract stipulated *inter alia* that the University would provide the building at 3 Chervonozorianyi Avenue, Kiev and in turn, B&P would perform certain renovation and redevelopment works to the building and that the building would then function as the Science-Hotel Complex. The 2003 Contract also provides that the parties will act jointly in the creation and operation of a research and hotel complex that will engage activities such as scientific activities, educational activities, organization of conferences, presentations, meetings, competitions, information services, hotel and catering services, among others, taking into account the statutory tasks of the University and the Company.

8. The contribution of the University to the Joint Activity would consist of tangible and intangible assets which includes the use of the building at 3 Chervonozorianyi Avenue, the performance of the second stage of operations, the use of the name of the University, to render the services that the University is entitled to render and the right to use the business reputation of the University. The amount of contribution by the University was estimated at UAH 6,449,000.

9. Under the 2003 Contract, B&P in turn would construct and assemble the first stage of reconstruction of the Science Complex in accordance with the approved construction documents, the value of the furniture, inventory and process equipment necessary for the functioning of the first stage, the creation of the fixed assets by the completion of the second stage of construction of the complex, a share contribution in the creation of the engineering transport infrastructure of Kiev, expenses related to repair work and arrangement of a service media of the intended premises. The total contribution of B&P shall be UAH 8,399,590 which is equal to 50% of the joint contribution of the parties.

10. The contract was signed by the parties on 29 January 2003 and is valid until 31 December 2027 or valid for 25 years. The 2003 Contract also provides that laws of the Ukraine shall govern the contract such as the terms and conditions for engaging in a joint activity, financial transactions of the joint activity, the grounds for the early termination of the contract, and on dispute settlement procedure. The contract also provides that the University shall be entitled to control the joint activity by examining the account and other documents of B&P with respect to the joint activity.

11. The construction work of the Science Hotel Complex proceeded throughout 2003 but the commencement of the second phase was delayed because, as the claimant alleged, they were having a difficulty in evicting illegal tenants of the building. Despite the delays, the parties agreed that the Science-Hotel Complex would open on 1 August 2005.

12. In October 2006, the University's Financial and Business Activity Control Department commenced an internal audit of the joint activity. The purpose of the audit was to ascertain whether B&P was in compliance with the 2003 Contract for the 2003-2006 periods.

13. On 29 December 2006, the internal audit found a number of irregularities in B&P's performance of its contractual obligations which included among others that B&P was not using the building in accordance with the terms of the 2003 Contract and that it was not undertaking any joint educational activities with the University. The Control Department also made findings of other breaches by B&P which includes: B&P's failure to keep an inventory of the Joint Activity's assets, in breach of Article 8(2) of the 2003 Contract, B&P leasing some equipment without having assigned inventory numbers on the leased equipment, the recruitment of B&P of employees who were not aware that they were employed by the Joint Activity, and B&P's violation of Ukrainian tax legislation. The University Control Department concluded that based on the irregularities that they found, B&P owed the University UAH 124,036.60.

14. In November and December 2006, the General Control and Revision Office of the Ukraine Ministry of Finance ("CRO") carried an audit of the University that included a cross revision of the Joint Activity which included the inspection of B&P's documents relating to the Joint Activity. The CRO found several violations and irregularities of B&P under the 2003 Contract, like the failure to open a separate joint activity account and its failure to conduct the activities required under the 2003 contract because the building consisted of hotel rooms and commercial premises, and also that two families were living in the building hence it was mainly used for commercial purposes and not for educational purposes. B&P protested the findings and they sent a complaint to the CRO, the Ministry of Finance and the State Prosecutor's Office but they only got a pro-forma reply from the Ministry of Finance. The CRO issued an Audit

Report on 29 December 2006 essentially adopting the findings made in the Cross Revision Report.

15. On May 2007, the CRO wrote to the University that in the course of the Audit, they have confirmed various instances of non-conformity with Ukrainian law and made 15 recommendations to the University which dealt with a range of issues and which were expressed in mandatory terms. One of the breaches identified by the CRO was B&P's operation of the Science Hotel Complex. The CRO directed the University to "take effective measures to eliminate completely the established inconsistencies and to bring the guilty officials to responsibility with respect to these breaches" and to "consider the question of termination of joint activities with B&P as such as inconsistent with the University status being a State budget maintained institution as well as return the assets to the above-mentioned company".

16. On 13 September 2007, the University requested B&P to agree to the termination of the 2003 Contract due to the various breaches of B&P as identified by the CRO. On 21 September 2007, B&P refused the University's request and asserted that any disputes should be settled under the provisions of the BIT between the United States and the Ukraine.

17. On 2 October 2007, the University initiated proceedings before the Kiev Commercial Court for the termination of the 2003 Contract and the transfer of B&P's 50% interest in the joint venture to the University. On 29 October 2007, Judge Kovtun ruled that the Kiev Commercial Court has no jurisdiction over the case and agreed with B&P that the dispute should be settled before the ICSID. He did not accept the claim of the University.

18. On 2 November 2007, the University commenced new proceedings in the Kiev Commercial Court requesting the same relief. B&P objected to the proceedings because Judge Kovtun already ruled in their favor on the same issue. In the submissions, B&P objected to the ruling of Judge Khrypun on jurisdictional grounds

only and it did not address the University's claim on the merits of terminating the 2003 Contract.

19. On 16 January 2008, Judge Khrypun issued a judgment ruling in favor of the University terminating the 2003 Contract. Judge Khrypun rejected B&P's contention that the BIT was applicable to the dispute between the parties and that the 2003 Contract was "commercial", hence the dispute is subject to the jurisdiction of the Ukrainian courts under article 12 of the Code of Commercial Procedure of Ukraine. On the merits, Judge Khrypun ruled that B&P's acts and omissions amounted to a material breach of the 2003 Contract which justified its termination. B&P appealed to the Kiev Commercial Court of Appeal and on 3 June 2008, the appellate court rejected the appeal. B&P appealed the appellate court's judgment to the High Commercial Court of Ukraine and the latter rejected the appeal on 19 September 2008.

20. On 28 March 2008, the University instituted a third set of proceedings before the Kiev Commercial Court requesting for the eviction of B&P from the Science and Hotel Complex. On 10 June 2008, the Kiev Commercial Court granted the University's request and ruled that since the contract was terminated in a judgment of 16 January 2008, B&P should be evicted from the complex and ordered that it be transferred to the possession of the University. On appeal to the Kiev Commercial Court of Appeal, the latter dismissed B&P's claims. B&P further appealed the ruling of the Kiev Commercial Court on the eviction case and the High Commercial Court of Ukraine also rejected the appeal and upheld the ruling of the appellate court.

21. On 13 January 2009, the Kiev Commercial Court ordered for the eviction of B&P from the Science and Hotel Complex and the University requested that the State Enforcement Office of Ukraine execute the order. B&P failed to vacate on the deadline given by the State Enforcement Office which is midday on 16 January 2009. From 19-20 January 2009, the representatives of the University and the State Enforcement Office forcibly carried out the eviction of B&P and its representatives from the complex.

22. In a separate proceeding, B&P filed a complaint before the Kiev Commercial Court which it registered on 10 June 2008 for the revocation of the power of attorney previously granted by the University to B&P to be able to carry out joint activities concerning the Science-Hotel Complex. The court rejected B&P's claim on the ground that the 2003 Contract had been validly terminated in a prior judgment. The Kiev Commercial Court of Appeal rejected B&P's appeal.

23. On 3 December 2007, the Claimants filed a Request for Arbitration with the ICSID and on 21 August 2008, ICSID registered the request. The Claimants alleged in their request that they had made an investment in the Ukraine, which is the 2003 Contract entered into by B&P with the University for the development of the Science Hotel Complex. The Claimants also alleged that through the conduct of state entities of the Ukraine, the contract was terminated and that B&P was evicted and that the conduct of the entities breached Ukraine's obligation under the Treaty Between the United States of America and Ukraine Concerning the Encouragement and Reciprocal Protection of Investment (US-Ukraine BIT).

2. *Legal Issues Discussed in the Award*

(a) *Jurisdiction of the Tribunal over the Claimants' Claims (paragraphs 114-140)*

1. The Claimants assert that they are companies of the US which have an investment in the Ukraine which falls within the scope of the protection of the BIT. They argued that Bosh is an enterprise incorporated under the laws of New Jersey and that B&P although incorporated in the Ukraine, should be considered as a company of the United States because 94.5% of its shares are owned by Bosh. The Claimants also belatedly argued that the principal jurisdictional controversy between the parties concern the claim asserted by them under the umbrella clause of the BIT.

2. The Respondent did not contest the standing of Bosh and B&P to assert a claim under the BIT. The Respondent did not challenge the Claimants' submission that they have made an investment in Ukraine within the meaning of the BIT. The Respondent also did not pursue its objection that the tribunal lacked jurisdiction due to the contractual nature of the claims, but rather asserted that the Claimants' claim neither arose under the BIT nor amounted to "investment disputes". The Respondent objected to the Claimants' claim under the umbrella clause of the BIT saying that the claim was made too late and is "untimely" because of the failure of the claimant to articulate their umbrella clause claim until the substantive hearing and in their post hearing brief.

3. The Tribunal finds that Bosh and B&P are "companies" within the meaning of the BIT and that Claimants have made an investment in the Ukraine and are entitled to invoke the investor-State dispute settlement procedure under Article VI of the BIT. The Tribunal also found that the Claimant's claim under the umbrella clause is within the Tribunal's jurisdiction although it was made in an untimely fashion. Accordingly, the Tribunal ruled that it has jurisdiction over all the Claimants' claim, and non is inadmissible.

(b) *Attribution of the conduct of the state-entities to the Respondent in relation to the claims of the Claimants (paragraph 141 to 184)*

1. *The CRO, the Ukrainian Courts and the Ministry of Justice.* The Tribunal determined that the conduct of the CRO as an independent financial control authority within the Ministry of Finance of Ukraine is plainly attributable to Ukraine. The conduct of the Ukrainian courts, as the judicial arm.

2. *The University.* The Tribunal used Article 5 of the ILC Draft Articles on State Responsibility to determine whether the conduct of the university is attributable to Ukraine. The Tribunal agreed with the Respondent that in order for the University's conduct to be attributable to Ukraine, it must both established that: (1) the University is

empowered by the law of Ukraine to exercise elements of governmental authority; and (2) the conduct of the University relates to the exercise of that governmental authority. On the first element, the Tribunal determined that the University through various laws and regulations of the Ukraine exercises certain elements of governmental authority although it is given a separate legal entity and large degree of autonomy. On the second element, the Tribunal determined that it is only the “governmental activity” of the University that is attributable to Ukraine under Article 5 and not its “private or commercial activity”. Furthermore, the Tribunal enunciated that the entering into and the subsequent termination of the 2003 Contract with B&P is a “commercial activity” of the University which is not within its governmental functions, hence the act of entering and terminating the 2003 Contract is attributable to Ukraine and that the conduct of the University in the subject matter of the proceedings is not attributable to Ukraine.

(c) *Whether or not the conduct of the CRO amounted to breach of articles II (3)(a) (fair and equitable treatment) and III (expropriation) of the BIT (paragraphs 185-220)*

1. *Fair and Equitable Treatment.* In considering the issue of whether there was a breach of the fair and equitable treatment as a result of CRO’s conduct, the Tribunal was guided by the ruling in *Joseph Charles Lemire v. Ukraine* which observed that “in order to establish a breach of the obligation under Article II (3)(a) of the BIT, ‘[i]t requires an action or omission by the State which violates a certain threshold of propriety, causing harm to the investor, and with a causal link between action or omission and harm.’”¹ The Tribunal in the instant case said that based on the evidence presented before it, “there is nothing to indicate that the CRO’s Audit and Cross-Revision was not in fact carried out in accordance with the applicable Ukrainian laws and regulations. In particular, the Claimants have not established that the CRO’s Audit of the University was anything other than an audit conducted in accordance with the

¹ Award, paragraph 212

Law of Ukraine ‘On the State Control and Revision Service in Ukraine’, which states that the main task of the State Control and Revision Service is to exercise financial control over the use of State funds. In this regard, the Tribunal accepts that the CRO’s Audit constituted a routine review of the University’s use and management of State funds, and there is no evidence demonstrating that B&P was targeted as a foreign investor.”² The Tribunal also considered that B&P was entitled to, and was accorded, appropriate due process in the course of the CRO’s Cross-Revision.

3. The Tribunal also rejected the Claimants’ assertion that the 10 May 2007 letter of CRO to the University constituted an unambiguous direction to the University to terminate the 2003 Contract. The Tribunal said that the letter did not amount to a direction to terminate the contract but only to “consider the question of termination of the joint activities with B&P LTD as such as inconsistent with the University status being a State budget-maintained institution as well as return the assets to the abovementioned company”. In other words, the CRO gave the University the discretion to choose how to address the concerns on the 2003 Contract, which includes the possibility of termination. For these reasons, the Tribunal held that the conduct of the CRO did not constitute a breach of the obligation to accord fair and equitable treatment under the BIT.

4. *Expropriation.* The Tribunal rejected the claim of the Claimants that the conduct of CRO in its letter of 10 May 2007 was a direction to terminate the 2003 Contract amounted to expropriation. According to the tribunal, in order for an action to amount to expropriation, the “Claimants must establish that the effects of CROs conduct was an interference that caused a substantial deprivation of the Claimants’ rights under the 2003 Contract”, citing the case of *Pope and Talbot Inc v. Canada*. The Tribunal consistent with its conclusions concerning the Claimants’ claim for breach of

² *Id.* at paragraph 213

fair and equitable treatment CRO's action did not terminate the 2003 Contract because CRO carried out its functions in accordance with applicable Ukrainian law and regulations and the final determination was made by the University, hence CRO's conduct did not amount to expropriation.

- (d) Whether or not the conduct of the University through its officials constituted a failure to act in good faith and thus contrary to the obligation of fair and equitable treatment under the BIT. (paragraphs 221-228)***

The Tribunal on this issue determined that the conduct of the University in the termination of the 2003 Contract is not attributable to Ukraine under international law as discussed in the determination of attribution of conduct in the award, thus the Tribunal rejected the Claimants' claims for breach of fair and equitable treatment under the BIT for the University's conducts and dealings with B&P.

- (e) Whether or not there was a breach of article II (3) of the BIT (umbrella clause) on the allegation of the Claimants that the University and its officials committed a substantial breach of the 2003 Contract contrary to Ukrainian law. (paragraphs 229-259)***

1. The submission of the Claimants that "the umbrella clause in the BIT permits them to assert their contractual claims under the BIT, for such provisions have the effect of elevating contractual claims to the level of a treaty" was held untenable by the Tribunal and ruled that the conduct of the University that is the subject matter of the proceedings is not attributable to the Respondent as previously ruled by the Tribunal in this case. The Tribunal held that "to the extent that the University failed to comply with its obligations under the 2003 Contract, or committed a substantial breach of that contract, that conduct is not attributable to the Respondent."

2. The Tribunal took the position that in order for a contractual claim under the umbrella clause in the BIT, the Claimants (in this instance B&P) is required to have its rights and obligations under the 2003 Contract determined by the applicable dispute settlement forum, in this case, the parties should settle disputes in accordance with Ukrainian legislation or simply put, B&P should follow the dispute settlement

mechanism in the 2003 Contract. In this instance, the 2003 Contract, provides for an exclusive jurisdiction clause that requires any dispute arising from the contract to be submitted to Ukrainian courts. In this case, the parties already litigated in the three level courts of the Ukraine which decided that they have jurisdiction over the dispute on the termination of the 2003 contract and that they ordered termination in accordance with Ukrainian legislation, hence B&P could not now claim that it has rights to properly assert a claim under the umbrella clause of the BIT.

(f) *Whether or not there was a breach of Article II(3)(a) of the BIT when the Ukrainian courts and the Ministry of Justice failed to act consistently with the principle of res judicata during the termination proceedings before the courts.*

1. The Claimants argued that the conduct of the Ukrainian courts and the Ministry of Justice on the initiation by the University of new proceedings on 2 November 2007 is a violation of the principle of *res judicata* and consequently a breach of the obligation to accord fair and equitable treatment under the BIT. The Tribunal rejected this claim because the fresh proceedings are not considered *res judicata* in Ukrainian law as presented by an expert before the Tribunal. The Tribunal further stated that this is primarily a question of Ukrainian law and in “only in situation where those proceedings would offend a sense of judicial propriety” that it would open the Tribunal to find that those proceedings did not meet international standards”. The application of the *res judicata* principle in Ukrainian law maybe different from other jurisdictions but it does not at all breach the threshold of offending judicial propriety, thus the Tribunal cannot reject the findings of the Ukrainian courts on this issue.

2. The Tribunal also noted that the Claimants were not denied due process in any way before the various proceedings in Ukrainian courts. B&P had every opportunity to present its case as can be seen from the various cases in the courts that it filed.

3. The Tribunal also found that there is no evidence that the Ministry of Justice abetted the courts in any breach of the BIT since they did not hinder the claimants to appear and make submissions before the Ukrainian courts. For the foregoing reasons, the Tribunal rejected the claims of the Claimants on this issue.

3. Costs

The Tribunal awarded the sum of USD 150,000 as costs against the Claimants.