

**Iurii Bogdanov, Agurdino, Invest Ltd, Agurdino–Chimia JSC**

**v.**

**Moldova**

**22 September 2005**

**Claimants:** Iurii Bogdanov, Agurdino, Invest Ltd, Agurdino–Chimia JSC;

**Respondent:** Republic of Moldova.

## **1. Introduction**

### **1.1 Institution of arbitral proceeding**

On 21 October 2004 the Claimants initiated against the Respondent an arbitration proceeding under the Rules of Arbitration of the Arbitration Institute of the Stockholm Chamber of Commerce, based on the Bilateral Investment Treaty entered into by and between the Republic of Moldova and the Russian Federation on 17 March 1998 (hereinafter referred to as the “**BIT**”).

On 21 December 2004 the Arbitration Institute of the Stockholm Chamber of Commerce appointed Professor Giuditta Cordero Moss, Oslo, as sole arbitrator in the dispute.

The Respondent failed to effect payment of its share of the advanced costs provided for by the Arbitration Rules of the Arbitration Institute of the Stockholm Chamber of Commerce. Upon the request of the Claimants, the amount of the claim was reduced, so that the

advanced costs already paid by the Claimants on their own behalf would be sufficient to cover the totality of the advanced costs, including also the Respondent's share.

On 30 March 2005 the Arbitration Institute of the Stockholm Chamber of Commerce referred the case to the Arbitral Tribunal. According to article 33 of the Arbitration Rules of the Arbitration Institute of the Stockholm Chamber of Commerce, the award is to be rendered not later than 30 September 2005.

## **1.2 Short description of the case**

### **1.2.1 The Claimants**

Iurii Bogdanov (hereinafter the “**Foreign Investor**” or the “**Claimant**”), a Russian citizen resident in the Republic of Moldova, established Agurdino–Invest Ltd. a wholly owned investment company in the Republic of Moldova (hereinafter the “**Local Investment Company**”). On 20 April 1999 the Local Investment Company entered into a contract with the Department of Privatization of the Republic of Moldova (the “**Privatization Contract**”), for the purchase of a majority shareholding in the capital of a company that later was re-named as Agurdino–Chimia JSC (hereinafter the “**Privatized Company**”). The Foreign Investor, the Local Investment Company and the Privatized Company are referred to hereinafter, jointly, as the “**Claimants**”.

### **1.2.2 The Respondent**

The Respondent is the Government of the Republic of Moldova.

### **1.2.3 The facts**

The Privatization Contract provided among others, in section 5.5, that the Local Investment Company should transfer to the State certain assets of the Privatized Company (the “**Transferred Assets**”), in exchange of shares in companies owned by the State in other, not specified companies (the “**Compensation Shares**”). Such transfer of assets and

compensation in state-owned shares is in accordance with a Governmental Regulation No. 482 of 1998.

The Local Investment Company complied with all its obligations under the Privatization Contract, including also the obligation under section 5.5 about the Transferred Assets, following which the Privatized Company repeatedly requested compensation in Compensation Shares, in accordance with the Privatization Contract and the Regulation No 482 of 1998. The existence and the amount of the claim to compensation do not seem to be in dispute, since they have been acknowledged by the Department of Privatization in its letters dated 19 November 2003 and 10 May 2004.

However, the due compensation has not yet taken place.

The first request of Compensation Shares made by the Privatized Company (dated 19 November 2001 and 17 October 2002) was rejected by the Department of Privatization (by letter dated 7 November 2002). The reason for rejecting the request was that the Privatized Company had requested shares that did not appear on a list of state-owned shares that are eligible as Compensation Shares (the “**List of Eligible Compensation Shares**”). The List of Eligible Compensation Shares contained only shares of companies in which the State owned less than 30% of the capital. Such criterion was based on an Order issued by the Department of Privatization on 17 December 2001, that introduced this restriction to the possibility to choose Compensation Shares.

The second request of Compensation Shares made by the Privatized Company (dated 31 July 2003) was also rejected by the Department of Privatization. The reason for rejecting the request was that the Privatized Company had requested shares that were removed from the List of Eligible Compensation Shares following a request by the Ministry of Agriculture and Food Industry on 30 October 2003.

The third request of Compensation Shares made by the Privatized Company (dated 12 November 2003) was again rejected by the Department of Privatization (by letter dated 19 November 2003). The reason for rejecting the request was that the State did not own a

number of the requested shares that was sufficient to compensate the value of the Transferred Assets.

### **1.3 The relief sought by the Claimants and legal grounds**

The Claimants affirm that the possibility to obtain a real compensation for the Transferred Assets is negatively affected by the Department of Privatization's application of its Order of 17 December 2001, containing the cap of 30% state ownership for the companies whose shares may be included in the List of Eligible Compensation Shares. The cap was later, on 4 February 2003, further reduced to 25% state ownership, and codified into an amendment to the Governmental Regulation No 482 of 1998. The Claimants argue that the introduction of the cap limited the range of eligible Compensation Shares to shares that do not have any effective value.

The Claimants argue that the restriction contained in the Order of 17 December 2001 (and, a fortiori, the restriction contained in the 2003 amendment to the Regulation No 482 of 1998) are not applicable to the compensation of the Transferred Assets, the Order and the amendment having entered into force after the obligation to compensate arose under the Privatization Contract and after the transfer of the Transferred Assets was perfected. The Claimants invoke Moldovan law, including also article 43 of the Foreign Investment Act, protecting against retroactive application of legislation.

The violation of the principle of non-retroactivity is the only legal ground pleaded by the Claimants as basis for their request of relief in the Statement of Claim and the Additional Written Statement, and the legal sources invoked in this connection are the Foreign Investment Act and the Regulation No 482 of 1998, and the Act on entry into force of official acts NO 173–XIII of 1994. The Claimants list also, as applicable sources, the BIT and the Minsk Convention of 28 March 1997 on the Protection of the Rights of the Investor (signed by, i.a., the Republic of Moldova and the Russian Federation); however, in the Statement of Claim and the Additional Written Statement the Claimant fail to make any legal arguments or present any legal grounds in respect of these sources.

The Claimants request that the nominal value of the Transferred Assets, plus interests thereon, is compensated in money in lieu of Compensation Shares. The Claimants request,

further, reimbursement of the moral damage allegedly caused by the Respondent's conduct. The legal basis that the Claimants invoke for their requests of relief is article 226 paragraph 2 of the Civil Code of the Republic of Moldova.

The Arbitral Tribunal asked both parties by notice dated 18 April 2005 to comment on the matter of jurisdiction of the Arbitral Tribunal. To such notice the Claimants answered in the letter dated 25 April 2005 supplementing the Statement of Claim, by making a generic reference to article 10 paragraph 2(b) of the BIT. The Respondent did not answer.

The Arbitral Tribunal asked both parties by notice dated 12 August 2005 to comment on whether the BIT is deemed violated by the Respondent's conduct, and to explain Moldovan law in respect of reimbursement of damages, including the admissibility of indirect and moral damages, the assessment of reimbursable damages, the payment of interests on overdue amounts. On 25 August 2005 the Arbitral Tribunal asked the parties to produce evidence that the BIT entered into force. To such notices the Claimants answered on 29 August 2005. The Claimant pleaded that article 6 of the BIT was violated by the Respondent's conduct; the Claimant introduced in the response to the Arbitral Tribunal's requests for clarification also new legal arguments and new evidence, which are inadmissible because they were presented too late in the proceeding. The Respondent did not answer.

#### **1.4 Respondent in procedural default**

The Respondent did not appoint a counsel to represent it in the proceeding and did not participate in the proceeding.

The Respondent, however, was given the possibility to participate in the proceeding:

- (i) all documents sent by the Arbitration Institute of the Stockholm Chamber of Commerce and by the Claimants to the Arbitral Tribunal appear to have been sent also to the Respondent,

- (ii) all communication by the Arbitral Tribunal was notified to the Claimants and the Respondent in accordance with articles 20(5) and 12 of the Rules of Arbitration of the Arbitration Institute of the Stockholm Chamber of Commerce,
- (iii) the Arbitral Tribunal emphasized in two written notices to both parties that the arbitral proceeding would continue and the award would be rendered even without the participation of the Respondent, in accordance with articles 10(5) and 28 of the Rules of Arbitration of the Arbitration Institute of the Stockholm Chamber of Commerce,
- (iv) all time schedules decided by the arbitral tribunal were submitted to both parties, and both parties were given the possibility to comment upon them before the time schedules were finally decided,
- (v) the time schedules decided by the Arbitral Tribunal throughout the proceeding provided for equal, successive terms for each of the Claimants and the Respondent to present their respective arguments and evidence, and the final time schedule permitted the Respondent a late participation in the proceeding, and
- (vi) by notice in the Russian and in the English language, the Arbitral Tribunal offered the parties to decide the language of the Arbitration.

The foregoing shows that the Respondent was given the possibility to participate in the proceeding; failure by the Respondent to do so, therefore, cannot prevent the continuation and conclusion of the arbitral proceeding and the issuance of the present arbitral award, in accordance with articles 10(5) and 28 of the Rules of Arbitration of the Arbitration Institute of the Stockholm Chamber of Commerce.

On 15 September 2005 the Claimants transmitted to the Arbitral Tribunal copy of a Decision taken by the Government of the Republic of Moldova on 17 August 2005, No 83–d, requesting the Ministry of Economy and Commerce to examine the materials relating to

an arbitral dispute pending before the Arbitration Institute of the Stockholm Chamber of Commerce between the company Agurdino–Invest Ltd and the company Agurdino–Chimia JSC, on one side, and the Republic of Moldova, on the other side. The Decision No 83–d by the Government of the Republic of Moldova is not a procedural act of the Respondent with relevance to the instant proceeding, since it was not addressed by the Respondent to the Arbitral Tribunal, it does not identify the instant dispute as its object, it does not contain any reply by the Respondent to the requests of the Arbitral Tribunal, nor any request by the Respondent to the Arbitral Tribunal or any information for the Arbitral Tribunal on the jurisdiction, the merits or the law applicable to the instant proceeding. Even if the Decision No 83–d was considered to have a relevance to the dispute, moreover, it would not be timely because the last term that was given to the Respondent for presenting its Additional Written Statement was 8 July 2005.

The Decision No 83–d, therefore, does not prevent the Arbitral Tribunal from continuing the instant arbitral proceeding according to the time schedules resolved by the Arbitral Tribunal, agreed on by the Claimants and not objected to by the Respondent.

### **1.5 Waiting period for amicable settlement**

In accordance with article 10(2) of the BIT, an arbitral proceeding may be initiated after an amicable settlement of the dispute has been attempted for a period of six months.

The Claimants notified the Respondent on 9 April 2004 of their proposal of amicable settlement, to be followed by the arbitral proceeding in case of failure to succeed.

The Respondent answered by letters dated 27 April 2004 and 12 August 2004, showing us readiness to effect the compensation sought by the Claimants on the basis of the List of Eligible Compensation Shares. However, the letters by the Respondent do not address the issue raised by the Claimants, i.e. the legitimacy of restricting the range of Compensation Shares to the List of Eligible Compensation Shares. On the basis of such letters, therefore, it does not seem that the attempt to reach an amicable settlement had a chance to be successful.

Therefore, it was admissible to start arbitral proceeding in accordance with article 10(2) of the BIT as from 9 October, 2004.

## **2. Jurisdiction**

The Request for Arbitration presented by the Claimants is based on Article 10(2) of the BIT. Article 10(2) of the BIT contains a standing offer of arbitration by the host country, in this case the Republic of Moldova, that was accepted by the Claimant instituting the present arbitral proceeding. The arbitration agreement is thus perfected by the institution of the arbitral proceeding; this is generally considered as a sufficient basis for the jurisdiction of investment arbitration (*PAULSSON, J., "Arbitration Without Privity", in 10 ICSID Review—Foreign Investment Law Journal 232 (1995)*).

Upon the Request of the Arbitral Tribunal to prove the entry into force of the BIT, the Claimant produced evidence that the BIT was ratified in the Republic of Moldova on 25 June 1998 and in the Russian Federation on 28 May 2001.

The Respondent did not respond to the Arbitral Tribunal's request. An independent investigation carried out by the Arbitral Tribunal showed that the Russian Ministry of Foreign Affairs, being the last contracting party that ratified the BIT, sent to the other contracting party the notice confirming ratification on 18 July 2001. In accordance with its article 14, therefore, the BIT entered into force upon receipt by the Moldovan Ministry of Foreign Affairs or the notice dated 18 July 2001.

To verify the scope of its jurisdictions, the Arbitral Tribunal makes the following observations:

### **2.1 Jurisdiction *ratione materiae***

Article 10(1) of the BIT extends the offer of arbitration to any disputes between a contracting state (in this case, the Republic of Moldova) and an investor of the other contracting state arising in connection with an investment. The language of article 10(1) permits to extend the jurisdiction of the Arbitral Tribunal to any dispute between qualified



parties (on the question of which parties qualify see below, section 2.2), as long as it arises in connection with an investment as defined in the BIT, and irrespective of whether the dispute is based on an alleged breach of the BIT, an alleged breach of a contract between the parties, or other alleged breach of obligation (*SCHREUER, C., "Investment Treaty Arbitration and Jurisdiction over Contract Claims – the Vivendi I Case Considered", in WEILER, T. (ed), Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law, 2005. p. 299, and ID., "Consent to Arbitration", cit., pp. 9f.*).

Article 1(2) of the BIT defines as "Investment" any kind of assets, including also shares, held by an entity of one contracting Mate in the territory of the other contracting state.

On the basis of the foregoing, the present dispute, regarding a contract for the acquisition of shares in the territory of a contracting state (in this case, the Republic of Moldova), falls within the scope of article 10(1) of the BIT and may be decided upon by the Arbitral Tribunal, as long as the parties to the dispute qualify under the BIT (see section 2.2 below).

The circumstance that disputes regarding privatization are excluded from arbitration under article 15 of the Minsk Convention does not affect the jurisdiction of the Arbitral Tribunal under the BIT, as article 21 of the Minsk Convention explicitly states that differing regulations contained in other international agreements (such as the BIT and its article 10(1) on arbitration) prevail over the regulation of the Minsk Convention.

## **2.2 Jurisdiction *ratione personae***

### **2.2.1 The Claimants**

As described in section 1.2 above, three entities are involved on the side of the Claimants:

- (i) the Foreign Investor,
- (ii) the Local Investment Company, and (iii) the Privatized Company.

To verify whether the Claimants enjoy protection under the BIT, and consequently whether they are entitled to act as Claimants in the present arbitral proceeding, it is necessary to

look at article 1(1) of the BIT, where the term “Investor” is defined. According to article 1(1), the following entities are considered as Investors under the BIT and enjoy treaty protection:

- (i) any individual having the nationality of one contracting state and making an investment in the territory of the other contracting state, and
- (ii) (ii) any legal entity constituted under the laws of one contracting state and making an investment in the territory of the other contracting state.

Not all the three Claimants, therefore, enjoy treaty protection under the BIT:

- (i) The Foreign Investor meets the criteria set forth in article 1 (1) of the BIT, because he is an individual having the nationality of the Russian Federation and making an investment in the Republic of Moldova. The Arbitral Tribunal underlines that in the practice of international investment arbitration it is generally accepted that protection under investment treaties (such as the BIT) is given to the shareholders of investment companies, even if the investment is actually carried out by a subsidiary constituted under the laws of the host country, such as, in this case, the Local Investment Company (*SCHREUER, C., Shareholder Protection in International Investment Law*, in *Transnational Dispute Management* Volume 2 – Issue #03 June 2005, pp. 6ff. and *ALEXANDROV, S.A., “The “Baby Boom” of Treaty– Based Arbitrations and the Jurisdiction of ICSID Tribunals: Shareholders as “investors” and Jurisdiction Ratione Temporis*, in *6 The Journal of World Investment & Trade, 2005, pp. 393ff.*). The investment protected by the BIT, in other words, is not the investment made by the Local Investment Company in acquiring the shares of the Privatized Company, but the investment made by the Foreign Investor in establishing and funding the Local Investment Company;
- (ii) The Local Investment Company does not meet the criteria set forth in article 1(1) of the BIT, because it is a company constituted under the laws of the country where the investment is made. The Local Investment Company is, admittedly, constituted under the laws of Moldova as a company with foreign investment, and subject to the Foreign Investment Act. This circumstance, however, is not

sufficient to extend to the Local Investment Company the protection of the BIT, since the definition of “Investor” contained in article 1(1) may not be unilaterally modified by the internal legislation of one contracting state. To the extent that the Foreign Investment Act regards the Local Investment Company as a foreign investor and extends to it the protection granted in the Republic of Moldova to foreign investors, any violation of the guarantees enjoyed by foreign investors and affecting the Local Investment Company will be unlawful under Moldovan law. However, the Arbitral Tribunal's jurisdiction derived from the BIT is limited to unlawful conduct that has caused a damage to a party protected by the BIT, and the Local Investment Company does not enjoy treaty protection. The Arbitral Tribunal is aware that under certain circumstances international law recognizes the criterion of foreign control, i.e. that the nationality of a company may be determined on the basis of the nationality of the shareholders, and that therefore a company registered in the host country might qualify as a foreign investor, if the shareholders of that company are foreign. This criterion is applied on the basis of article 25(2) (b) of the Washington Convention Of 1965 establishing the ICSID, Article 1(1) of the BIT, on the contrary, does not extend the definition of “Investor” with the help of the criterion of foreign control; the Arbitral Tribunal, therefore, does not deem the criterion of foreign control applicable to the Local Investment Company.

- (iii) The Privatized Company does not meet the criteria set forth in article 1(1) of the BIT, because it is a company constituted under the laws of the same country where the investment is made.

The Arbitral Tribunal, therefore, accepts jurisdiction for claims presented by the Foreign Investor, but cannot accept jurisdiction for claims presented by the Local Investment Company or by the Privatized Company.

The Arbitral Tribunal observes, in this connection, that the Foreign Investor in the Request for Arbitration, the Statement of Claim and the remaining arbitral documentation is listed as a Claimant but appears as Claimant not in its own name, but in the name of the Local

Investment Company and of the Privatized Company. The Arbitral Tribunal considers this presentation of the role of the Foreign Investor as the result of a clerical error: if the Foreign Investor did not act also in his own name, the request of awarding damages also to the Foreign Investor, contained in the Statement of Claim, would not make any sense. The Arbitral Tribunal, therefore, considers the claim presented by the Foreign Investor as presented both on behalf of the Foreign Investor himself and on behalf of the Local Investment Company and the Privatized Company. On the basis of the foregoing, the Arbitral Tribunal considers the claim presented on behalf of the Foreign Investor as admissible, whereas the claims presented on behalf of the other parties are not admitted due to lack of jurisdiction.

As a consequence of this decision of the Arbitral Tribunal regarding its jurisdiction, the request of relief made by the Claimants must be restricted to the Foreign Investor only, and cannot apply to the Local Investment Company and the Privatized Company.

The Arbitral Tribunal has the authority to make this correction to the relief sought by the Claimant in the Statement of Claim, because this correction does not introduce a new relief that was not sought by the Claimants, nor a legal source that was not mentioned as legal basis for the proceeding or a fact that was not pleaded in the proceeding; the correction simply recognizes one of the Claimants, the Foreign Investor, as the party entitled to the requested measures, and regards the requested relief, the payment of a sum of money, as indirect damage rather than as payment of the money equivalent in lieu of Compensation Shares (should the allegations made by the Claimant be accepted by the Arbitral Tribunal).

Under Swedish arbitration practice, which is applicable to this proceeding, it is established that the principle of *iura novit curia* applies; therefore, the Arbitral Tribunal, in applying the law, is not bound by the pleadings made by the parties, and may by its own motion apply legal sources or legal qualifications that have not been pleaded by the parties. In respect of international arbitration taking place in Sweden, it is sometimes suggested that the principle *iura novit curia* applies, but the parties should be notified of new legal sources introduced by the arbitrator, so that they have the possibility to comment on them. Leaving aside the question of the necessity of following such suggestion on a general basis, the Arbitral Tribunal observes that, in the instant case, the Arbitral Tribunal does not introduce

a new legal source: it applies the legal sources invoked by the Claimant in a way different from the way pleaded by the Claimant. Under Swedish arbitration law the right of the arbitrators to make their own legal qualifications is not limited, even if this results in imposing remedies different from those pleaded by the parties (*HEUMAN, L., "Arbitration Law of Sweden: Practice and Procedure", Stockholm, 2003, pp 610f.*). Also in respect of international disputes arbitrated in Sweden it is recognized that arbitrators should be able to present legal arguments on a rationale that neither party has presented (*HEUMAN, L., "Arbitration Law of Sweden: Practice and Procedure", cit., p. 379*). The Arbitral Tribunal, did, however, request both parties to comment on the matter of jurisdiction. The circumstance that the parties have not presented any arguments in this connection cannot prevent the tribunal from applying the law as it deems appropriate. This conclusion is confirmed by ICSID practice, see *SCHREUER, C., "Three Generations of ICSID Annulment Proceedings", in GAILLARD, E., BANIFATEMI, Y. (eds.), Annulment of ICSID Awards, 2004, pp. 30f.*

### **2.2.2 The Respondent**

The Privatization Contract, which is the basis of the claim, was entered into by the Department of Privatization of the Republic of Moldova. In respect of the disputed compensation for the Transferred Assets, the Department of Privatization was authorized by Governmental Regulation No 482 of 1998 to carry out the compensation procedure.

The Department of Privatization is, therefore, a central Governmental body of the Republic of Moldova, delegated by Governmental regulations to carry out state functions, and the effects of its conduct may be attributed to the State. It is generally recognized, in international law, that States are responsible for acts of their bodies or agencies that carry out State functions (See Article 4 of the ILC Articles on State Responsibility, and *CRAWFORD, J., "The International Law Commission's Articles on State Responsibility", Cambridge 2003, p. 94*). The State of the Republic of Moldova is, therefore, the correct respondent.

This is indirectly confirmed by the letters dated 27 April 2004 and 12 August 2004, by which the Respondent answered the Claimants' notification of their proposal of amicable

settlement, to be followed by the arbitral proceeding in case of failure to succeed. The Claimants' notification was addressed to the Republic of Moldova, and the answers were written by the Department of Privatization, without any objections to the identity of the addressee.

### **2.3 Jurisdiction *ratione temporis***

According to Article 13 of the BIT, treaty protection is enjoyed by investments that took place after 1 January 1992.

The Privatization Contract was entered into in 1999, and is therefore covered by the BIT.

## **3. Basis for the award**

### **3.1 The pleadings made by the Claimant**

The facts, evidence and legal arguments upon which the Arbitral Tribunal is requested to render the award were presented by the Claimant in the Request of Arbitration, the Statement of Claim and the Additional Written Statement, in accordance with the Arbitration Rules of the Arbitration Institute of the Stockholm Chamber of Commerce and the time schedules proposed by the Arbitral Tribunal, agreed upon by the Claimant and not objected to by the Respondent. Since the Respondent was in default, and since all evidence was produced by the Claimant in writing, the Arbitral Tribunal decided (and the parties did not object thereto) not to hold an oral hearing. The Arbitral Tribunal, however, did not consider the legal arguments presented to it sufficient to make a decision on the merits of the dispute, and requested the parties to clarify their respective legal arguments in respect of the violation (if any) of the BIT by the Respondent and in respect of the regime of reimbursement of damages under Moldovan law.

The written statement submitted by the Claimant in response to the Arbitral Tribunal's request for clarifications constitutes also basis of this award, to the extent that it addresses the matters on which the Arbitral Tribunal had requested clarifications. The new legal arguments and new elements of evidence introduced in this statement by the Claimant

beyond the clarifications requested by the Arbitral Tribunal were not admissible at such a late stage of the proceeding, and are not taken into consideration.

### **3.2 The applicable law**

To evaluate the pleadings presented by the Claimant, the Arbitral Tribunal applies the BIT and the law of the Republic of Moldova. The law of the Republic of Moldova is applicable on the basis of the BIT, is pleaded by the Claimant and is considered applicable by the Arbitral Tribunal on the basis of the choice of law rule contained in article 24 of the Arbitration Rules of the Arbitration Institute of the Stockholm Chamber of Commerce (it being the law of the host country of the investment and mandatorily applicable to questions regarding the privatization of state assets).

### **3.3 Independent analysis by the Arbitral Tribunal**

The circumstance that the Respondent did not present its case does not, as already mentioned in section 1.4 above, prevent the continuation of the arbitral proceeding.

However, this does not mean that the Arbitral Tribunal is obliged to accept the pleadings of the Claimant as well-founded without any independent evaluation.

Therefore, the Arbitral Tribunal evaluated the facts and the legal arguments presented by the Claimant in light of the applicable sources of law, as presented by the parties.

The Arbitral Tribunal did not engage in fact finding or legal investigations on behalf of the Respondent to compensate the latter's lack of assistance: it simply evaluated the facts and legal arguments as presented by the Claimant in order to satisfy itself of their soundness.

## **4. The Findings of the Arbitral Tribunal**

On the basis of the foregoing, the Arbitral Tribunal finds as follows:

#### **4.1 The principle of non-retroactivity**

The Claimant argues that a real compensation for the Transferred Assets cannot be obtained because of the Department of Privatization's application of its Order of 17 December 2001, limiting the range of Compensation Shares by applying a cap of 30% state ownership for the companies whose shares may be included in the List of Eligible Compensation Shares. The cap was later, on 4 February 2003, further reduced to 25 % state ownership, and codified into an amendment to the Governmental Regulation No. 482 of 1998. Application of the Order and of the amendment to the Regulation violate, according to the Claimant, the principle of non-retroactivity of legislation, contained in Moldovan law and, in particular, in article 43 of the Foreign Investment Act.

The Arbitral Tribunal observes initially that it seems beyond any doubt that the Foreign Investor (as well as the Local Investment Company) fall within the scope of application of the Foreign Investment Act, according to the definition contained in Article 2 of the Act.

In evaluating whether application of the mentioned criterion restricting the List of Eligible Compensation Shares is unlawful, the Arbitral Tribunal observes first that the Privatization Contract does not contain guidelines on how the Compensation Shares shall be chosen; it is therefore necessary to look at Governmental Regulation No 482 of 1998, which was in force when the Privatization Contract was entered into, and to which therefore the Privatization Contract, is subject. In article 10 c), the Regulation No 482 of 1998 states that the identity of the Compensation Shares shall be agreed upon between the Ministry of Finance, the Department of Privatization and the creditor. No further guidelines are contained in the Regulation.

This means, on the one hand, that the restriction to shares in companies in which the State owns less than 30% is not contained in the Regulation; on the other hand, however, it means that the Regulation does not provide for an obligation by the competent authorities to accept any request of Compensation Shares made by the creditor, nor does it contain restrictions regarding the criteria that the competent authorities may apply to agree on the eligibility of the state-owned shares as Compensation Shares. By making reference to an agreement to be reached between the parties, the Regulation contains an element of



discretion for both parties, permitting them to evaluate whether to agree or not. The Order issued by the Department of Privatization may be deemed to be a concretization of the discretionary power that the competent authorities enjoy on the basis of article 10 c) of the Regulation No 482 of 1998 and does not seem, therefore, to introduce a restriction to the eligibility of shares that could not have been applied under the original version of Regulation No. 482 of 1998.

Even if the Order in itself were not considered applicable because it was issued after the obligation to compensate arose, the criterion of the cap of state ownership contained therein might still be applied as part of the Department's discretion based on article 10 c) of the Regulation No 482 of 1998. Application of this criterion lies within the frame of the Regulation No 482 of 1998 as it was in force at the time of the Privatization Contract, which the Claimants must be deemed to have accepted by signing the Privatization Contract without specifying in its article 5.5 any criteria to limit the competent authorities' discretion in reaching an agreement on the Compensation Shares.

On the basis of the above, the Arbitral Tribunal finds that the Respondent's decision to determine the compensation of the Transferred Assets by exchanging shares contained in the List of Eligible Compensation Shares may not be deemed a violation of the principle of non-retroactivity of legislation contained in Moldavian law and, in particular, in article 43 of the Foreign Investment Act.

## **4.2 Other legal grounds under the BIT**

### **4.2.1 Compensation mechanism without substance**

The Claimant argues that the criterion upon which the List of Eligible Compensation Shares is based deprives the compensation of its substance, because the shares contained in the list have a market value that is substantially lower than their face value.

The List of Eligible Compensation Shares is, as set forth in section 4.1 above, a concretization of the wide discretion that the competent authorities enjoyed under the Regulation No. 482 of 1998 and the Privatization Contract. By entering into the

Privatization Contract without specifying the criteria for the eligibility of the Compensation Shares, the Claimant accepted the risk of not being able to reach a completely satisfactory agreement on the identity of the Compensation Shares. A specification of the competent authorities' discretion, even if it may reduce the effective value of the compensation, lies within the borders of a conduct that is permissible under the Privatization Contract and Regulation No. 482 of 1998. The right acquired by the Claimant with the Privatization Contract was, in other words, so vague, that a concretization thereof was necessary and does not appear to be arbitrary to the Arbitral Tribunal.

The questions that remain are whether using the criterion of the cap of state ownership to concretize the discretion regarding the eligible Compensation Shares in fact deprives the compensation mechanism of its substance, as alleged by the Claimant, and whether this circumstance has legal consequences that the Arbitral Tribunal has to act upon.

The List of Eligible Compensation Shares refers to nearly 150 companies; the concretization of the criterion for the eligibility of the Compensation Shares does not seem, therefore, to have unreasonably limited the number of eligible shares. The Claimant produced evidence that some of the shares of companies included in the List of Eligible Compensation Shares have a market value that is substantially lower than their nominal value, and seeks, by so doing, to establish that all shares contained in the List of Eligible Compensation Shares have a much lower market value than their nominal value. The Arbitral Tribunal regrets that the Respondent failed to participate in the proceeding and therefore failed to assist the Arbitral Tribunal in the evaluation of the allegations presented by the Claimant. The Arbitral Tribunal underlines that under Swedish arbitration law, which is applicable to this proceeding, a certain evidential significance may be attached to a party's passivity (*HEUMAN, L., "Arbitration Law of Sweden: Practice and Procedure", cit., pp.404f.*). Failure by the Respondent to comment on the Claimant's allegation gives the Arbitral Tribunal reason to conclude that the Respondent cannot produce evidence that the threshold of state ownership has no effect on the value of the shares.

Therefore, having regard to the lack of evidence or arguments presented by the Respondent to rebut the Claimant's allegations, the Arbitral Tribunal accepts the evidence

produced by the Claimant as sufficient to prove the point made by the Claimant, i.e. that the List of Eligible Compensation Shares consists of shares with a market value that is materially lower than their nominal value.

#### **4.2.2 Relevance under the BIT**

The Arbitral Tribunal observes that it has jurisdiction to interpret and to apply Moldovan law, but not to evaluate whether the contents of the internal legislation or normative acts of the Republic of Moldova are satisfactory. The Arbitral Tribunal, however, has the authority to evaluate whether the Respondent's conduct violates obligations contained in the BIT.

The Claimant did not invoke other legal grounds apart from the violation of the non-retroactivity principle. The Claimant did not argue that the Respondent's conduct violates the BIT: however, the BIT is put forward by the Claimant as one of the legal sources to be applied in the proceeding. As already explained under section 2.2.1 above, the Arbitral Tribunal is not limited to the legal arguments made by the parties. As long as the Arbitral Tribunal limits its evaluation to the facts as presented by the parties, it remains free, within the borders of the applicable law (particularly, as long as it remains within the frame of the legal sources mentioned in the proceeding), to give the legal qualifications and determine the legal consequences that it deems appropriate, even if they were not pleaded by the parties. Swedish arbitral practice recommends that the parties are invited to comment on new legal sources introduced by the arbitrators. The Arbitral Tribunal observes that this recommendation has the aim of preventing that the parties are taken by surprise by the consideration of legal issues that were not taken into consideration in the proceedings (*HEUMAN, L., "Arbitration Law of Sweden: Practice and Procedure", cit., pp.324ff.*). In the present proceeding, even though the Claimant did not invoke any specific article of the BIT, the BIT constitutes the legal basis of the arbitral proceeding, as the Claimant has initiated the present proceeding under the BIT, and has listed the BIT as one of the legal sources to be applied in the decision. Therefore, consideration of the BIT may not be deemed as a surprise to any of the parties. However, considering the importance of the interpretation and application of a Bilateral Investment Treaty, the Arbitral Tribunal deemed it advisable to request both parties to expressly comment on the violation (if any) of the BIT by the Respondent, so as to ensure, *ex abundante cautela*, that both parties were given the

possibility to present their arguments in respect of the applicability of the BIT's rules to the dispute.

In its answer to the Arbitral Tribunal's invitation to comment on the violation of the BIT, the Claimant made reference to Article 6 (discussed below, in section 4.2.5). The Respondent did not respond.

The Arbitral Tribunal finds that the conduct documented by the Claimant is to be evaluated in the light of the principles of full protection contained in article 2 of the BIT, fair and equitable treatment contained in article 3 of the BIT, and indirect expropriation contained in article 6 of the BIT.

#### **4.2.3 Full protection**

Article 2(2) of the BIT contains the obligation of the host country to guarantee, in accordance with its own legislation, full and unconditional legal protection of the investments made by investors of the other contracting state.

The question is whether the full protection standard is violated by the introduction of the cap of share ownership. The wording of article 2(2) of the BIT makes clear that the full protection principle is not to be considered as a corrective of the host country's legislation, but has to be applied in accordance with the host country's law. As long as the restrictions regarding the choice of Compensation Shares are in accordance with Moldovan law, therefore, the full protection standard of the BIT may not be deemed violated.

As explained in section 4.1 above, the Arbitral Tribunal finds that the conduct of the Respondent does not violate Moldovan law; therefore, the Respondent's conduct is not in violation of the full protection standard contained in article 2 of the BIT.

#### **4.2.4 Fair and equitable treatment**

Article 3 of the BIT contains the obligation of the host country to grant to the foreign investor a fair and equitable treatment, excluding discriminatory measures that could prevent the management or availability of the investment.

The second paragraph of article 3 specifies the fair and equitable treatment by reference to the standards of national treatment and most favoured nation treatment.

The question is whether the fair and equitable treatment standard is violated by the application of the cap on share ownership. A restrictive interpretation of Article 3 of the BIT might indicate that the fair and equitable treatment standard is equivalent to the absence of discriminatory measures, including national treatment and most favoured nation treatment.

From the pleadings made by the Claimant it does not appear that the Claimant was affected by discriminatory measures, or that the Respondent's conduct towards the Claimant differed from that towards Moldovan nationals or nationals of other countries. On the contrary, the Order and the amendment that the Claimant contests have a general scope and are applicable to all entities that participated in privatization.

The fair and equitable treatment standard, however, must be interpreted in accordance with the ordinary meaning of the terms, as well as the object and purpose of the BIT (see the Vienna Convention on the Law of Treaties, Article 31). The purpose of the BIT, in accordance with its preamble, is to promote and protect investments by creating investment-friendly conditions. Therefore, the fair and equitable treatment granted in Article 3 must be interpreted to cover also any conduct that, even if it is in compliance with the national law of the host country and it is not discriminatory, has unjust or unreasonable results (*SCHREUER, C., "Fair and Equitable Treatment in Arbitral Practice", in Journal of World Investment and Trade, 2005, 357ff., p. 367*). Even if the evaluation of what is fair and equitable is necessarily based on the specific circumstances of the case, various criteria have been developed in international law to define the fair and equitable standard. Among the parameters that are recurrently applied to verify the compliance with this standard, are the principles of transparency and the protection of the investor's legitimate expectations

(*SCHREUER, C., "Fair and Equitable Treatment", cit., pp. 374ff.*), as well as the principle of good faith (*Ivi.*, pp. 383ff.).

As explained in section 4.1 above, the Arbitral Tribunal considers that the Respondent is entitled, under the Privatization Contract and under the Regulation No 482 of 1998, to restrict the choice of eligible Compensation Shares according to its reasonable discretion. As explained in section 4.2.1 above, the Arbitral Tribunal considers, that the Claimant, also due to the Respondent's passivity, successfully proved that the criterion upon which the List of Eligible Compensation Shares is made deprives the compensation mechanism of substance, and that the Respondent failed to prove that the List of Eligible Compensation Shares is based on reasonable criteria.

The question that remains is whether the criterion applied by the Respondent in compiling the List of Eligible Compensation Shares is abusive and arbitrary, because it deprives the compensation mechanism of substance without any reasonable foundation, and whether this circumstance represents a violation of the fair and equitable treatment standard.

The Arbitral Tribunal observes that the Claimant agreed in the Privatization Contract to a mechanism of compensation on the basis of the face value of shares owned by the state. The Privatization Contract failed to specify the criteria according to which such shares should be chosen. It is in the normal course of events that the market value differs from the face value of shares. By entering into the Privatization Contract on such vague terms, the Claimant must have been aware of the risk that the compensation in Compensation Shares at their face value might not be fully satisfactory.

The Arbitral Tribunal finds that, even if the Respondent is entitled to restrict the choice of eligible Compensation Shares according to its reasonable discretion, and the Claimant must be deemed to have accepted the risk connected therewith, the Respondent was not entitled to choose the Compensation Shares in such a way that the compensation was deprived of its value. By taking this measure, the Respondent has in practice avoided to pay compensation for the Transferred Assets, thus negatively affecting the Claimant's legitimate expectations of obtaining compensation (even if not necessarily a fully satisfactory compensation).

The Arbitral Tribunal, therefore, finds that the Respondent, by establishing a system for compensation of the Transferred Assets that permitted an abusive application and by its subsequent application, is in violation of the fair and equitable treatment standard contained in article 3 of the BIT.

#### **4.2.5 Indirect expropriation**

Article 6 of the BIT contains the obligation of the host country to proceed to direct or indirect expropriation only for a purpose in the public interest, in a non discriminatory way, in accordance with the due process of law, and accompanied by the payment of prompt, adequate and effective compensation. If one of these criteria, is not met, article 6 of the BIT is deemed violated.

A transfer of assets without compensation might, therefore, under certain circumstances amount to an indirect expropriation and a violation of article 6 of the BIT. Even if the restriction contained in the List of Eligible Compensation Shares was deemed to prevent an adequate compensation for the Transferred Assets, however, the Arbitral Tribunal does not find Article 6 of the BIT applicable, because the concept of indirect expropriation applies only to measures having the effect of expropriation that affect the totality or a substantial part of the investment (*SCHREUER, C., "The Concept of Expropriation under the ETC and other Investment Protection Treaties", in Transnational Dispute Management Volume 2 — Issue #03 June 2005, pp.5ff.*). In the instant case, the value of the Transferred Assets, upon which the parties agree, corresponds to less than 7% of the nominal value of the Privatized Company at the moment of the Privatization Contract, and circa 3% of the total investment carried out by the Local Investment Company. This is not sufficient to turn the lack of compensation for the Transferred Assets into a measure affecting the totality or a substantial part of the investment.

In conclusion, the Arbitral Tribunal does not deem that the Respondent's conduct is in violation of the prohibition of indirect expropriation without adequate compensation contained in article 6 of the BIT.

### **4.3 Other legal sources**

The Claimant lists also the Minsk Convention as a source applicable to the present proceeding; however, the Arbitral Tribunal does not consider this instrument as applicable, because its Article 15 excludes disputes regarding privatization from arbitration. Moreover, no articles in the Minsk Convention seem to be violated in the instant case. In the statement of Claim and the Additional Written Statement, the two documents where the parties were supposed to present their legal arguments, the Claimant failed to explain what specific rules of the Minsk Convention are allegedly violated by the Respondent's conduct, and in what way they should be applicable.

## **5. Assessment of damages**

### **5.1 The quantification of the loss**

The Arbitral Tribunal considers the following circumstances sufficiently proven by the documentation produced by the Claimant, and observes that the documentation originating from the Respondent, that was produced by the Claimant, directly confirms the correctness of the first three circumstances mentioned below:

- (i) The Local Investment Company transferred the Transferred Assets to the Respondent, or an agency thereof, in accordance with the Privatization Contract entered into between the Local Investment Company and the Respondent;
- (ii) The Privatization Contract provides for compensation of the Transferred Assets by assigning Compensation Shares to the statutory fund of the Privatized Company for a value equal to the nominal value of the Transferred Assets, amounting to 621021 lei;
- (iii) Compensation has not taken place;



- (iv) The Respondent is entitled to offer Compensation Shares according to its discretion, but the criterion applied by the Respondent to compile the List of Eligible Compensation Shares deprives the compensation of any substance;
- (v) The Respondent's conduct caused a loss to the Local Investment Company, because the assets and the statutory fund of the Privatized Company (wholly owned by the Local Investment Company) were decreased by the value of the Transferred Assets and were not increased by a corresponding value of Compensation Shares;
- (vi) According to Regulation No 482 of 1998, the loss of the Local Investment Company amounts to the nominal value of the Transferred Assets.

In the practice of investment arbitration it is generally accepted that the shareholders may be awarded indirect damages (*SCHREUER, C., "Shareholder Protection in International Investment Law", cit., pp. 18f.*). The remedy that may be, claimed by the Foreign Investor, therefore, is not limited to the damage directly affecting his rights as shareholder in the Local Investment Company, but extends to any losses affecting the assets of the Local Investment Company, including also any reduction in value of the assets due to any alleged breach of contract by the Respondent, The indirect damage suffered by the Foreign Investor, therefore, corresponds to the loss of the Local Investment Company, assessed as in item (vi) above.

## **5.2 Respondent's liability for reimbursement of damages**

The Arbitral Tribunal does not find that the Respondent is liable for payment of damages corresponding to the entire loss, and that the Local Investment Company must be deemed partially responsible for the loss because it did not ensure that the Privatization Contract contained an appropriately precise regulation of the compensation.

Article 6 of the Moldovan Civil Code authorizes the Arbitral Tribunal to estimate the the Respondent is liable to pay.

Under the Arbitral Tribunal's estimate the part of loss which the Respondent has to reimburse amounts to 310000 lei.

The Claimant requested also reimbursement of moral damages. The Arbitral Tribunal observes that the Claimant failed to produce any factual evidence for moral damages. Therefore, the Arbitral Tribunal rejects the request of reimbursement of moral damages.

### **5.3 Interest**

The Arbitral Tribunal considers interest payable in the amount documented by the Claimant, up to the date of the Claimant's Additional Written Statement (as requested by the Claimant), as follows: interests calculated at the rate of 30.98% from 19 June 2001 (on 190000 lei) and from 16 August 2001 (on 120000 lei) to 31 December 2001, at the rate of 24.18% from 1 January 2002 to 31 December 2002, at the rate of 21.05% from 1 January 2003 to 31 December 2003, at the rate of 23% from 1 January 2004 to 31 December 2004, and at the rate of 23% from 1 January 2005 to 31 March 2005.

The Arbitral Tribunal does not consider it appropriate to increase the amount of damages by the inflation rate, in addition to computing the average bank interest rate, as the interest rate already includes a compensation for the inflation.

### **5.3 Currency**

The Arbitral Tribunal observes that the Claimant requests payment of the equivalent in Euro of the amounts calculated in lei. The Arbitral Tribunal does not deem it appropriate to award payment of damages in Euro, since the credit of the Local Investment Company, which represents the indirect damage to the Claimant to be reimbursed by the Respondent, is expressed in lei. The Claimant failed to present any legal foundation for converting the payment into Euro.

## **6. Allocation of costs**

According to article 40(2) of the Arbitration Rules of the Arbitration Institute of the Stockholm Chamber of Commerce, the Arbitral Tribunal decides on the allocation of the arbitration costs between the parties taking into account the outcome of the case and other circumstances.

In view of the inconvenience caused by the Respondent's uncooperative attitude, and even though the requests presented by the Claimant were only partially accepted, the Arbitral Tribunal decides that all the costs of the arbitration shall be borne by the Respondent, but that each party shall bear its own costs incurred in connection with the proceeding.

## **7. Award**

For the reasons stated above, the Arbitral Tribunal renders the following:

### **Arbitral Award**

1. The Respondent, Republic of Moldova, is ordered to pay to the Claimant, Iurii Bogdanov, damages in the sum of 694896 lei (corresponding to a principal of 310000 lei, plus interest calculated at the rate of 30.98% from 19 June 2001 (on 190000 lei) and from 16 August 2001 (on 120000 lei) to 31 December 2001, at the rate of 24.18% from 1 January 2002 to 31 December 2002, at the rate of 21.05% from 1 January 2003 to 31 December 2003, at the rate of 23% from 1 January 2004 to 31 December 2004, and at the rate of 23% from 1 January 2005 to 31 March 2005);

2. In accordance with the decision of the Arbitration Institute of the Stockholm Chamber of Commerce, the sole arbitrator and the Arbitration Institute shall be entitled to fees and compensation for expenses in the following amounts:

a. Giuditta Cordero Moss, sole arbitrator

Fees EUR 17250

Costs EUR 2207

b. The Arbitration Institute  
Administrative Fee EUR 6000  
Sum Total EUR 25457

The parties are jointly and severally liable to pay the costs of the arbitration with EUR 25457 as specified above. The costs shall be drawn from the advanced costs deposited by the Claimants with the Arbitration Institute of the Stockholm Chamber of Commerce;

3. As between the parties, the Respondent shall be responsible for 100% of the above mentioned costs of the arbitration. The totality of the advanced costs having been paid by the Claimants, the Respondent is ordered to pay to the Claimant, Iurii Bogdanov, the arbitration costs, amounting to EUR 25457;

4. Each party is to bear its own costs and expenses connected with the arbitral proceedings, including also counsel fees;

5. Payments to be made by the Respondent to the Claimant shall occur within 30 days from the date hereof. In case payment is not made or only partially made by that date the Respondent shall pay default interests at the rate of 23% for payments in lei and of 2.5% for payments in Euro, compounded quarterly.

Stockholm, 22 September 2005  
Giuditta Cordero Moss  
Professor Dr Juris