**Kyrgyz investment law and the problem of expropriation: Would the Indian Model BIT help?**

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## Abstract

Regrettably, nowadays the Kyrgyz Republic encounters a substantial amount of expropriation claims arising out of investor-to-state dispute settlement cases. This system allows foreign investors to request huge amounts of compensation for any government intervention that would have an adverse effect on their investments. In addition to it, vaguely stipulated expropriation rules in the BITs, to which Kyrgyzstan is a party, primarily favors the interests of foreign investors. Hence, this paper seeks to suggest a legal definition of indirect expropriation that strikes an appropriate balance between, on the one hand, the rights of foreign investors and, on the other hand, the sovereign regulatory authority of the country. For this reason, expropriation clause under the Indian Model BIT is analyzed and compared with the expropriation clauses under the BITs, which have been used as the legal basis for claims of foreign investors against Kyrgyzstan. Further, it examines whether the use of expropriation clause under the Indian Model BIT would have precluded the disputes or positively have changed the outcomes for Kyrgyzstan should it be used instead of the expropriation clause invoked by the investors against Kyrgyzstan.

It is concluded that, as such, expropriation rule under Article 5 of the Indian Model BIT does not strike a balance between the interests of host states and foreign investors. Moreover, it would not have changed positively the outcomes of investment disputes. Nevertheless, expropriation rule under the Indian Model BIT has the merit of establishing a flexible, case-specific set of factors to address the question of how to determine indirect expropriation. Moreover, it gives an opportunity to states to invoke a police power exception precluding the constitution of indirect expropriation. Hence, although, having not balanced the interests of host states and investors, the alternative expropriation rule under the Indian Model BIT would have helped Kyrgyzstan at least to invoke police power exception favoring the states' interests.

**Table of content**

## Introduction

An essential provision in BITs is the rule against expropriation, which prevents states from "taking" private property, directly or indirectly, except when certain requirements are met.[1] Typically, the requirements include the existence of a public purpose, a non-discriminatory application, due process, and prompt, effective and adequate compensation.[2] Unless all the aforementioned conditions are met, expropriation will be deemed unlawful.[3]

The risk that a foreign investment may be expropriated is considered one of the major factors that dissuades investors from investing abroad. Direct expropriation cases, where "an investment is nationalized or otherwise directly expropriated through formal transfer of title or outright seizure",[4] have become fewer.[5] Indirect expropriations cases, conversely, are multiplying.[6] They can stem from a measure or series of measures that do not necessarily deprive an investor of ownership rights, but have effects equivalent to an expropriation.[7] Most BITs do not provide standard for determination of whether the host country's regulatory measures amount to indirect expropriation.[8]

This paper focuses on the notion of indirect expropriation as it applies in investment cases involving the Kyrgyz Republic[9]. In particular, it seeks to suggest a legal definition of indirect



[1] Jeswald Salacuse, *The Law of Investment Treaties* (OUP 2015) 313-357; R. Dolzer & C. Schreuer, *Principles of International Investment Law* (OUP 2012) 98-129; A. Newcombe & Paradell, *Law and Practice of Investment Treaties* (Kluwer Law International 2009) 341-69.
[2] Ibid.
[3] Ibid.
[4] Model Text for the Indian Bilateral Investment Treaty (adopted in 14 January 2016), < file:///F:/%D0%94%D0%BE%D0%BA/investment/ModelBIT_Annex_0.pdf> accessed 30 May 2020 (hereinafter, 2016 Indian Model BIT), art. 5.3(a)(i).
[5] Prabhash Ranjan & Pushkar Anand, 'The 2016 Model Indian Bilateral Investment Treaty: A Critical Deconstruction' (2017) 38 Nw J Int'l & Bus <https://scholarlycommons.law.northwestern.edu/njilb/vol38/iss1/1> accessed 26 May 2020.
[6] Ibid, 31.
[7] Robert David Sloane & W. Michael Reisman, 'Indirect Expropriation and its Valuation in the BIT Generation' (2004) 120. *See Sporrong v Kingdom of Sweden Series A* (1982) 52 EHRR paras 60,63; *cf. De La Grange v Italy*, (1995) 19 EHRR 368, para. 26(d).
[8] Sloane (n 7) 33.
[9] This thesis uses the terms "Kyrgyzstan" and "Kyrgyz Republic" interchangeably and indistinguishably.

expropriation that strikes an appropriate balance between, on the one hand, the rights of foreign investors and, on the other hand, the sovereign regulatory authority of the country.

The BITs, to which the Kyrgyz Republic is a party, include the Moscow Convention on the Protection of the Rights of Investor 1997 (Moscow Convention)[10], the Kyrgyz-Turkish BIT 1992[11], and the Seoul Convention Establishing the Multilateral Investment Guarantee Agency (Seoul Convention)[12]. These multilateral and bilateral treaties mentioned above were applied in a number of expropriation cases brought against Kyrgyzstan by foreign investors, including *Beck*[13], *OKKV*[14] and *Sistem*[15]. In all three cases, tribunals found that indirect expropriation has taken place. [16]

The treaties to which the Kyrgyz Republic is a party, however, do not exhaust the scope of definitions of expropriation. For example, Article 5 of the Indian Model BIT provides a detailed explanation of the definition of expropriation instead of just stipulating that expropriation is prohibited.[17] Moreover, it lists several factors to be taken into account in determining indirect expropriation, thereby providing at least some guidance for tribunals.

In this paper, it is argued that vague and broadly termed expropriation clauses, such as those stipulated in the BITs to which Kyrgyzstan is a party, are the reason why the majority of indirect expropriation cases are mostly ruled in favor of the foreign investors against Kyrgyzstan. Since

[10] Convention on the Protection of the Rights of the Investor (signed 28 March 1997, entered into force 21 January 1999) (hereinafter Moscow Convention).
[11] Agreement between the Republic of Kyrgyzstan and The Republic of Turkey concerning the Reciprocal Promotion and Protection of Investment (signed in 28 April 1992, entered into force 31 October 1996).
[12] Convention Establishing the Multilateral Investment Guarantee Agency (concluded 11 October 1985, entered into force 12 April 1988) T.I.A.S. 12089, 1508 UNTS.
[13] *Beck & Central Asian Development Co v Kyrgyzstan*, Moscow Chamber of Commerce and Industry (hereinafter MCCI), Award No. A-2013/08 (13 November 2013).
[14] *OKKV v Kyrgyzstan*, MCCI, Award No. A-2013/10 (21 November 2013).
[15] *Sistem Mühendislik In aat Sanayi ve Ticaret A (hereinafter Sistem) v Kyrgyz Republic*, ICSID Case No. ARB(AF)/06/1, (9 September 2009).
[16] Invesment Policy hub, Investment Dispute Settlement Navigator <https://investmentpolicy.unctad.org/investment-dispute-settlement/country/113/kyrgyzstan> accessed 26 May 2020.
[17] 2016 Indian Model BIT (n 4), article 5.

investors rely on such vague expropriation clauses, none of the expropriation cases ruled in favor of the Kyrgyz Republic. Indeed, 5 out of 11 indirect expropriation cases were ruled in favor of investors, three of them are still pending, and four were discontinued and settled by the parties.[18] Hence, the question arises whether Kyrgyzstan actually benefits from foreign direct investment in reality. Another question is what can be done in order to improve the FDI's impact on Kyrgyzstan?

The replacement of expropriation rule in the BITS, to which Kyrgyzstan is a party, can be one of the responses to questions addressed above. Accordingly, the first chapter of this paper tests the expropriation clause under the Indian Model BIT against the expropriation clause under the Moscow Convention and the Turkish-Kyrgyz BIT, which have been used as the legal basis for claims of foreign investors against Kyrgyzstan. The second chapter explores whether the use of expropriation clause under the Indian Model BIT would have precluded the disputes that have thus far been brought against Kyrgyzstan or changed their outcomes in favor of the host state.



[18] Investment Policy hub (n 16).

## Chapter I. Defining Expropriation: A Comparison of the Kyrgyz BITs and the Indian Model BIT

This chapter focuses on a comparative analysis between the expropriation rule under the Indian Model BIT and that under the Moscow Convention and the Kyrgyz-Turkish BIT.

### 1.1. The expropriation rule under the Moscow Convention and the Turkish-Kyrgyz BIT

In line with Article 9 of the Moscow Convention, under which *Beck* and *OKKV* brought proceedings against Kyrgyzstan, a protection of investments against expropriation is stipulated as follows:

**"**investments shall not be liable to nationalization and may not be subjected to requisition except in exclusive cases (natural calamities, incidents, epidemic, epizootic and other circumstances of extreme character) stipulated by the national legislation of the Parties when such measures are taken in public interests stipulated by the Basic Law (Constitution) of the recipient country. Nationalization or requisition may not be implemented without paying the investor the adequate compensation."[19]

Further, it is stated that the decisions on nationalization or requisition of investments must be subject to due process and that they can also be subject to an appeal.[20] If such an appeal establishes that actions/omissions of state bodies or officials contradicted the national law of the host state and norms of international law, an investor has right to reimbursement of the damage caused to him by such actions/omissions.[21]



[19] Moscow Convention (n 10), article 9.
[20] Ibid, article 9.
[21] Ibid.

Accordingly, under the Moscow Convention, lawful expropriation whether direct or indirect requires a public purpose, due process and adequate compensation. However, there is no indication that the measures must be non-discriminatory. Also, the Convention only mentions the adequacy of compensation but not the promptness and effectiveness of the compensation. According to article 10 of the Moscow Convention, compensation must be paid in the same currency in which investments were invested and that the amount of the compensation must be established in line with the national law of the host state.[22]

Article III (1) of the Turkish-Kyrgyz BIT 1992, under which *Sistem* brought its expropriation claim against Kyrgyzstan, prohibits:

"expropriation, nationalization subject directly or indirectly, to measures of similar effect unless it is performed for public purpose, in a non-discriminatory manner, and upon payment of prompt, adequate and effective compensation and in accordance with due process of law and the general principles of treatment".[23]

With regard to general principles, Article III (1) of the Turkish-Kyrgyz BIT refers to Article II of the treaty. Article II (2) qualifies the general principles of treatment as encompassing treatment "no less favorable than that accorded in similar situations to investments of its own investors and of any third country within the framework of its laws and regulations", thereby establishing a non-discrimination obligation.[24] Article III (2), for its part, provides that compensation must be "equivalent to the real value of the expropriated investment before expropriation measures have taken place or became known and that compensation must be paid without delay and be freely transferrable".[25] Finally, under Article IV (2) Kyrgyz-Turkish BIT,

[22] Ibid, article 10.
[23] Turkish-Kyrgyz BIT (n 11), article III (1).
[24] Ibid, article II (2).
[25] Ibid, article III (2).

a transfer "must be made in the convertible currency in which the investment has been made or in any convertible currency at the rate of exchange in force at the date of transfer unless otherwise agreed by the investor and the hosting state."[26]

Accordingly, under the Kyrgyz-Turkish BIT, a lawful expropriation – whether direct or indirect – requires a public purpose, the absence of any discrimination, and prompt, adequate and effective compensation.

### 1.2. The test for expropriation under the Indian Model BIT

Article 5.1 of the Indian Model BIT states that: "neither party may nationalize or expropriate an investment of an investor of the other Party either directly or through measures having an effect equivalent to expropriation, except for reasons of public purpose, in accordance with the due process of law and on payment of adequate compensation."[27]

With regard to public purpose, it stipulates that "where India is the expropriating Party, any measure of expropriation concerning land must be for the purposes established by its Law relating to land acquisition and any issues as to 'public purpose' and compensation must be determined in accordance with the procedure specified in such Law".[28]

With respect to compensation, Article 5.1 states that it must be "adequate and be at least equivalent to the fair market value of the expropriated investment immediately on the day before the expropriation takes place and that compensation must be freely convertible and freely transferrable".[29]



[26] Ibid, article IV (2).
[27] 2016 Indian Model BIT (n 4), article 5.1.
[28] Ibid, footnote 3 to article 5.1.
[29] Ibid.

As can be seen, Article 5.1 and 5.2 do not differ much from Article 9 Moscow Convention and Article III Turkish-Kyrgyz BIT. However, starting from Article 5.3, which defines direct expropriation and the requirements to be met to find indirect expropriation, major differences can be noticed between the Indian Model BIT and the other instruments. Direct expropriation, within the meaning of Article 5.3(a)(i) of the Indian Model BIT, takes place "when an investment is nationalized or directly expropriated through formal transfer of title or outright seizure".[30] Under Article 5.3(a)(ii), indirect expropriation means "a measure or series of measures which has an effect equivalent to direct expropriation by substantially or permanently depriving the investor of the fundamental attributes of property involving the right to use, enjoy and dispose of its investment without formal transfer of title or outright seizure".[31]

Crucially, Article 5(3)(b) of the Indian Model BIT lists several factors to be taken into account when determining when state regulatory measures constitute indirect expropriation:

(i) "the economic impact of the measure or series of measures, although the sole fact that a measure or series of measures of a Party has an adverse effect on the economic value of an investment does not establish that an indirect expropriation has occurred;

(ii) the duration of the measure or series of measures of a Party;

(iii) the character of the measure or series of measures, notably their object, context and intent; and

(iv) whether a measure by a Party breaches the Party's prior binding written commitment to the investor whether by contract, license or other legal document".[32]



[30] Ibid, article 5.3 (a)(i).
[31] Ibid, article 5.3 (a)(ii).
[32] Ibid, article 5.3 (b).

Article 5.5 Indian Model BIT further accords police powers to host states, allowing their authorities and judicial bodies to take non-discriminatory regulatory measures that are "designed and applied to protect legitimate public interest or public purpose objectives such as health, safety and environment".[33] Any such measure "shall not constitute expropriation under this article".[34] Finally, Article 5.6 requires foreign investors to exhaust local remedies in the host state before initiating arbitration proceedings under the BIT.[35]

In this respect, Article 15.1 of the Indian Model BIT sets three-phased path of when a claim can be submitted to arbitration.[36] First, a disputing investor must bring a claim before domestic courts or administrative bodies for a breach of obligation under the BIT within 1 year from the moment on which the investor "first acquired or should have first acquired knowledge of the measure in question [...]."[37] Second, the investor must show that no satisfactory resolution has been made within at least five years after exhausting domestic remedies.[38] In sum, the investor must meet the condition that no more than 6 years have passed from the moment when "the investor first acquired or should have acquired knowledge of the measure in question".[39] Third, before submitting a claim to arbitration, it requires parties to resolve the dispute amicably through negotiation or other third party procedures within at least 6 months after the receipt of notice of arbitration.[40] Thus, third party procedures would take 9 months, since in addition to 6 months' period, parties must give notice of arbitration to the 'Defending Party' within 90 days before submitting a claim to arbitration.[41] Accordingly, by imposing limitations on



[33] Ibid, article 5.5.
[34] Ibid.
[35] Ibid, article 5.6.
[36] Ibid, article 15.1.
[37] Ibid.
[38] Ibid, article 15.2.
[39] Ibid, article 15.5 (i).
[40] Ibid, article 15.4.
[41] Ibid, article 15.5 (v).

timeframe, the Indian Model BIT shrinks the scope of ISDS claims to be brought against India.[42]

### 1.3 A comparison of applicable tests: which test is more suitable to the needs of the Kyrgyz Republic?

As the language above indicates, the first difference that draws attention is that neither Moscow Convention nor Turkish-Kyrgyz BIT provides a definition of expropriation, let alone the determination of direct and indirect expropriations separately. Article III (1) Turkish-Kyrgyz BIT stipulates only one criterion for indirect expropriation, i.e. "measures of similar effect"[43] while Article 9 Moscow Convention is absolutely silent about the indirect expropriation.[44]

On the contrary, Article 5.3 Indian Model BIT draws a clear line between direct and indirect expropriation. In particular, under Article 5.3 (a)(ii), a finding of indirect expropriation must be based on the substantial or permanent deprivation of the investor of the economic value, the right to use, enjoy and dispose of its investment.[45] Furthermore, Article 5.3(b) puts in place several factors to be taken into account by the tribunals to determine indirect expropriation which requires a case-by-case inquiry.[46]

Under Article 5.3 (b) (i) the economic impact must be taken into account but the only fact that state measures have a negative economic impact on investments is not sufficient for an



[42] Prabhash Singh et al., 'India's Model Bilateral Investment Treaty: Is India Too Risk Averse?' (2018) Brookings India IMPACT Series No. 082018.
[43] Turkish-Kyrgyz BIT (n 11), article III (1).
[44] Moscow Convention (n 10), article 9.
[45] 2016 Indian Model BIT (n 4), article 5.3 (a)(ii).
[46] Ibid, article 5.3 (b).

establishment of indirect expropriation.[47] Moreover, under Article 5.3 (b) (ii), the duration of the measures and under Article 5.3 (b) (iii) the character of the measures including their object, context and intent must be taken into consideration.[48] The prior commitments to the investor on the basis of contracts, licenses and other legal documents are also subject to consideration in line with Article 5.3 (b)(iii).[49] Finally, Article 5.5 Indian Model BIT provides an exception precluding the constitution of expropriation whereby non-discriminatory measures to which public purpose objectives are pursued do not establish expropriation.[50] Accordingly, if a measure satisfies these two conditions and even if it has an economic impact on the investments of investors, it will not be accompanied with compensation.

Over time, investment arbitral tribunals have established various tests to determine whether the state measures amount to indirect expropriation.[51] The first test, namely the "sole effects" test, focuses only on the severity of the effect of the regulatory measure on an investment.[52] Under this test, even when direct expropriation is not found, indirect expropriation could be established if a regulatory measure taken by the host state substantially deprives a foreign investor of the fundamental attributes of property in its investment.[53] The second test, called the "police power" test, focuses on whether state measures having an effect on a foreign investment pursuing legitimate aims.[54] If they do, they do not necessarily amount to expropriation.[55] The third test is the "proportionality" test, applied not only in investment



[47] Ibid, article 5.3(b)(i).
[48] Ibid, article 5.3(b)(ii), (iii).
[49] Ibid, article 5.3 (b)(iii).
[50] Ibid, art 5.5.
[51] Ranjan (n 5) 32.
[52] Ibid. *See* also Ben Mostafa, 'The Sole Effects Doctrine, Police Powers and Indirect Expropriation under International Law', (2008) 15 Australian J. Int'l. L 267, 267-296.
[53] Ibid. *See* also *Pope and Talbot v Canada,* NAFTA/UNCITRAL, Interim Award, para. 96 (June 26,2000).
[54] Ranjan (n 5) 33.
[55] Ian Brownlie, *Principles of Public International Law* (7th ed, OUP 2008) 532; G.C. Christie, 'What Constitutes a Taking of Property under International Law?' (1962) 38 Brit Y B Int'l L 307, 335-338.

disputes but also in determining legal issues in other spheres of law.[56] Under this test, the public purpose pursued to the regulatory measure must be proportionate to the outcome that measure has in a foreign investment.[57]

Article 5 of the Indian Model BIT includes all of the doctrines mentioned above. For example, Article 5.3(a)(ii) Indian Model BIT is a clear illustration of the sole effects/substantial deprivation test which is based on the severity of the economic impact on an investment.[58] Further, Article 5.3(b) reflects a proportionality test listing several factors, namely an economic effect of the measures on an investment, length of the measures, context in which the measure/s were adopted, intent of the host state in the adoption of such measures, their object and character.[59] Finally, Article 5.5 Indian Model BIT by stipulating the exception demonstrates the police power test under which non-discriminatory regulatory measures not associated with compensation do not constitute expropriation.[60]

The inclusion of all these tests in expropriation clause still leaves a wide discretion to tribunals as to which doctrine to apply to specific case. Depending on the determination of each tribunal, this may lead to recognizing the primacy of foreign investment protection over the sovereign power of states to regulate – or vice versa.[61] In other words, the Indian Model BIT has the merit of establishing a flexible, case-specific set of factors to address the question of how to determine indirect expropriation, but at the same time it risks setting forth a fuzzy, discretion-laden test. How should a tribunal accommodate the "sole effects" test, which requires only the



[56] Alec Stone Sweet, 'Investor-State Arbitration: Proportionality's New Frontier', Law & Ethics of Human Rights' (forthcoming 2010) 1, 18; Caroline Henckels, 'Indirect Expropriation and the Right to Regulate: Revisiting Proportionality Analysis and the Standard of Review in Investor-State Arbitration', (2012) 15:1 J. Int'l. Econ. L. 223-255.
[57] Ibid.
[58] 2016 Indian Model BIT (n 4), article 5.3(a)(ii).
[59] Ranjan (n 5) 34.
[60] 2016 Indian Model BIT (n 4), article 5.5.
[61] Ranjan (n 5) 34.

severity of the outcome of a measure on an investment (substantial deprivation test), with the "police power" focused on the legitimate purpose of a regulatory measure, while at the same time trying to strike a balance between public purpose and investors' protection?[62] Should the purpose behind the regulatory measure be accorded decisive weight, or should the substantial deprivation of a foreign investment prevail?[63]

Notwithstanding its volatility and uncertainty, the test set out under Article 5.3 of the Indian Model BIT enables an application of its factors on a case-to-case basis. Accordingly, in comparison to the imprecise rules against expropriation under Article 9 of the Moscow Convention and Article III of the Turkish-Kyrgyz BIT, Article 5 of the Indian Model BIT provides not only protection to investors' interests, but also the protection of those of the host state.

However, whether it actually strikes a balance between the protection of investors and a right host states to regulate is debatable. First, expropriation clause under Article 5 of the BIT guards more state interests by precluding the constitution of expropriation if a measure in question meets a minimum standard of being non-discriminatory and pursuing some public purpose objectives.[64] Second, as has been reflected in Article 5.6 and Article 15 of the BIT, it sets limitations on timeframe on when the dispute can be submitted to an arbitration and requires to resolve the dispute amicably before initiating an arbitration.[65] It shrinks the scope of investment claims to be brought against host states.



[62] Ibid.
[63] Ibid.
[64] Ibid, 36.
[65] 2016 Indian Model BIT (n 4) article 5.6 and article 15.

## Chapter II. Application of different tests to investment disputes arising out of expropriation claims

Having compared the test for indirect expropriation under the Indian Model BIT to that arising under the Moscow Convention and the Turkish-Kyrgyz BIT, it is now time to assess whether the former would be better suited to strike an appropriate balance between the interests of foreign investors and Kyrgyzstan. To this end, this chapter reviews some major investment cases brought against Kyrgyzstan in recent years and seeks to explore whether the test for indirect expropriation under the Indian Model BIT would have changed their outcomes in favor of Kyrgyzstan.

*Beck v. Kyrgyzstan* and *OKKV v. Kyrgyzstan*, both arose out of expropriation clause under the Moscow Convention and of operations in a Bishkek free economic zone.[66] The first award of 23 million USD was ruled in favor of a Korean investor – Mr. Beck and his Central Asian Development Corporation.[67] The second 2.2 million USD award was ruled in favor of 17 CIS investors and their limited liability company OKKV.[68] Both awards were reviewed and set aside by the Moscow Arbitrazh Court on the grounds that Article 11 of the 1997 Moscow Convention cannot be construed as an automatic right for claimants to bring cases before any arbitral forum of their choice.[69] However, this chapter focuses on the substantive analysis of expropriation rule, not on the jurisdictional grounds on which the awards were annulled.

These cases were chosen to illustrate that whilst a majority of the investment disputes arise out of indirect expropriations, the vagueness of the expropriation clause under the Moscow Convention did not benefit Kyrgyzstan and paved the way for favorable outcomes of investment disputes to foreign investors. Furthermore, the *OKKV* case involves various

[66] Roelin Knottnerus & Ryskeldi Satke, 'Kyrgyz Republic\s experience with investment treaties and arbitration cases' (2017) Transnat'l Inst Amsterdam 28.
[67] Ibid.
[68] Ibid.
[69] Ibid.

relevant issues such as the change of political regime and the 2010 revolution, which resulted in the issuance of a Decree by the Interim Government of Kyrgyzstan that deprived the investors from their investments and legitimate expectations under the investment contract.[70] On the other hand, *Beck* case is concerned with constant change in the regulatory environment, i.e. the taxation instability affecting businesses operating in the Bishkek free economic zone.[71]

The third case, the 8.5 million USD award ruled in favor of a Turkish investor in *Sistem v. Kyrgyzstan*, involves participation of all branches of the government of Kyrgyzstan, which raised a lot of questions to which there are still no answers.[72] The circumstances of the case were triggered by the revolution and the regime change in Kyrgyzstan in 2005.[73] This case clearly shows that it is a misconception to consider that the investment dispute arising between private business entities exempt Kyrgyzstan from its obligations under the BIT to which it is a party.[74] As such, it is concluded that ISDS system mostly favors the interests of foreign investors, whilst the Kyrgyz state's interests suffer from the outcomes of arbitral proceedings.

## 2.1. Beck v. Kyrgyz Republic

### 2.1.1. The outcome of the case under the Moscow Convention

In *Beck v. Kyrgyzstan* the claim arose out of an alleged expropriation of a Korean investor's investment by terminating Lease Agreement with respect to some land plots to develop a theme park in Bishkek.[75] Notably, the claim has arisen out of the Moscow Convention to which Kyrgyz Republic is a party. Remarkably, even though the government of Kyrgyz Republic



[70] *OKKV* (n 14).
[71] *Beck* (n 13).
[72] Nurbek Sabirov et al., 'Investment disputes: reasons, consequences and conclusions. Case study No. 2: *Sistem v. Kyrgyzstan'* (Investicionnye spory: prichiny, posledstvija, vyvody. Obzor No. 2: Arbitrazhnoe delo – *Sistem v Kyrgyzstan*) (K&A 2006) <http://www.k-a.kg/ru/investitsionnye-spory-prichiny-posledstviya-vyvody-obzor-2> accessed 30 May 2020.
[73] Knottnerus (n 68).
[74] Ibid.
[75] *Beck* (n 13).

was notified about the date and place of the hearing and was asked to provide its position on the alleged expropriation claim, it neither submitted counter-memorandum nor presented its position before the tribunal.[76] Therefore, the Moscow Chamber of Commerce and Industry (hereinafter MCCI) decided on the case without consideration of the interests of Kyrgyzstan.

Evidently, the MCCI's award was more fact-based and lacked analysis of the expropriation rule under the Moscow Convention. It did not refer to any case law, customary international law in order to analyze the rule and apply it to the facts of the case and often took the claimants' arguments at face value. Two factors may be the reason for that, first the only source revealing the facts and circumstances of the case was Beck – Claimant, while Kyrgyzstan's position on the claims of the investor was not presented. Second, Article 9 Moscow Convention was too wide and imprecise so that the tribunal lacked the legal instrument to base its analysis.[77]

With regard to factual background, in 1997 Lee John Beck, a Korean citizen, began to carry out operations by the invitation of the President and was registered as the subject of operations in the free economic zone in Bishkek.[78] Between 1999 and 2001, Claimant could not engage in investment activities, as there was an uncertainty regarding the application of tax and customs benefits to foreign investors carrying out their businesses in free economic zones in Bishkek.[79] Mr. Beck argued that by that time, many opportunities were missed including the loss of contacts with the business partners.[80]

After that uncertainty has been resolved, in 2002, all previous agreements with Beck were terminated.[81] Later, Central Asian Free Economic Zone (FEZ) Development Corporation, whose president was Mr. Beck and the General Directorate of the FEZ "Bishkek" (hereinafter



[76] Ibid.
[77] Moscow Convention (n 10), article 9.
[78] *Beck* (n 13).
[79] Ibid.
[80] Ibid.
[81] Ibid.

Directorate) concluded an agreement on the provision of a land plot with an area of 23 hectares for a period of 93 years with the aim of developing the Business Park, a brick factory and mortar-concrete unit (which should be transferred to the Bishkek FEZ in 10 years) and reconstruction of the Expocenter's building for 26 years and the implementation of other activities.[82]

In accordance with the agreement, a Flamingo children's park was built, a brick factory and a mortar-concrete unit were built and handed over to the FEZ Bishkek as was agreed, a partial reconstruction of the Expocenter was carried out, landscaping and gardening of the leased territory were also carried out by Claimant.[83] However, the Business Park project offered by him was rejected on the basis that the project was commercial in nature which did not comply with the goals and objectives of the FEZ "Bishkek", although, in accordance with clause 1.3.1 of Agreement, land was leased for 93 years and for "the development of the park and other activities."[84]

Claimant alleged, that from 2006 till 2012, in violation with Article 9 Moscow Convention, "creeping" expropriation within three stages took place.[85] First, he alleged the seizure of 5.328 $m^2$ of the leased territory in favor of "Jipara Enterprises"; second, the seizure of 11.718 $m^2$ of the leased land plot in favor of the State Enterprise Kyrgyzstroyservice and finally a unilateral termination of the Lease Agreement.[86] Claimant demanded compensation in an amount of approximately 23 million USD.[87] In particular, it claimed that termination of the Lease Agreement deprived it form control over his investment and a substantial income from his investment.[88]



[82] Ibid.
[83] Ibid, 11.
[84] Ibid, 12
[85] Ibid, 3.
[86] Ibid.
[87] Ibid.
[88] Ibid.

Having considered the claims and evidences provided, in accordance with Article 9 of the Moscow Convention, the MCCI considered the actions of the state as the indirect expropriation.[89] On account of the absence of the meaning of expropriation in the Moscow Convention, a tribunal applied Seoul Convention (the Kyrgyz Republic ratified this Convention and its member).[90] As provided for in Article 11 (a)(ii) of the Seoul Convention, expropriation or similar measures mean "any legislative action or administrative action or omission coming from the host government, as a result of which the holder of the guarantee loses ownership of his investment, control or substantial income from such an investment."[91]

The MCCI concluded that the investor's right was violated since 2002 taking into account the tax and customs regime change with respect to businesses carried out in the Bishkek free economic zone.[92] Further, it referred to the fact that Claimant was deprived of some territory of leased land plot without his consent and notification. It also supported Claimant's argument that it was executed in violation with Article 411 of the Civil Code of Kyrgyzstan, under which unilateral termination is prohibited unless it was terminated on the basis of the local court's decision in case of a fundamental breach committed by one of the parties.[93] Hence, the tribunal concluded that termination of the Lease Agreement deprived Mr. Beck of control and substantial income of such investment and awarded Claimant with the compensation in an amount of 23 million USD.[94]

[89] Ibid, 37.
[90] Ibid.
[91] Seoul Convention (n 12), article 11 (a)(ii).
[92] *Beck* (n 13).
[93] Ibid. The Civil Code of the Kyrgyz Republic (Grajdanskij kodeks Kyrgyzskoj Respubliki). Part I of 8 May 1996 # 15 (with latest amendments of 23 January 2009 # 23), article 411(2).
[94] *Beck* (n 13) 37.

### 2.1.2. The possible outcome of the case under the Indian Model BIT

In *Beck v. Kyrgyzstan*, the tribunal referred to the fact that "creeping" expropriation had taken place since 2002 taking into account the change of the taxation requirement on the businesses operating in the Bishkek free economic zone.[95] In this respect, Article 2.4 (ii) of the Indian Model BIT provides that the treaty must not apply to "any law or measure regarding taxation including measures taken to enforce taxation obligations".[96] Further, it states that the decisions of the host state that a specific regulatory measure is pertinent to taxation, irrespective of whether it made before or after the commencement of arbitral proceedings, must be "non-justiciable".[97] Finally, it restricts an arbitral tribunal to review such decisions.[98]

According to literal interpretation, this provision completely excludes issues related to taxation from the scope of the BIT, meaning that foreign investors will not be able in any circumstances to challenge such measures, even if they are confiscatory in nature.[99] In particular, this provision benefits the interests of the host state, since the host state has a final say on whether a regulatory measure is related to taxation or not.[100] Hence, should the Indian Model BIT be applied by the tribunal, taxation issue would have been disregarded. Even if at the moment of the conclusion of the Lease Agreement, under the Kyrgyz legislation, investments made in the free economic zone were not subject to taxation, and even if enforcement of taxation would have substantially deprived Beck of the economic value of the investment and/or control over such investment, the issue of taxation would have been excluded under the Indian Model BIT.



[95] Ibid.
[96] 2016 Indian Model BIT, article 4(ii).
[97] Ibid.
[98] Ibid. *See* also Ranjan (n 42) 34.
[99] Ibid.
[100] Ibid, 35.

With respect to seizure of several land plots of the investor to other enterprises including state enterprise, in total, Beck was deprived of 11, 749 hectares out of 23ha provided to him for 93 years without his consent and without modification of the Lease Agreement.[101] Such a deprivation, indeed, could have been construed as the substantial deprivation of "fundamental attributes of property in investment, including the right to use, enjoy and dispose of investment" under Article 5.3(a)(ii) of the Indian Model BIT.[102]

Furthermore, if it was taken into account as an economic impact under Article 5.3 (b)(i), it would lead to a very investor-friendly outcome as well.[103] The reasoning for both Article 5.3 (a)(ii) and Article 5.3 (b)(i) would be that the Directorate seized almost 50% of the leased territory - a measure sufficient enough to have a substantial adverse effect on Mr. Beck's investment. In addition to it, the seizure, as such, did not pursue any legitimate public purpose objectives, which might have been taken into account under Article 5.5 of the BIT as well as the duration of the measure under Article 5.3 (b)(ii) was permanent since claim appealing the seizure brought by Mr. Beck was not satisfied in domestic courts.[104] Article 5.3 (b)(iii) requires the tribunal to consider the character and nature of the measure on a case-by-case basis, which is only relevant when the measure is confiscatory.[105] Since there was no indication that the state measures were confiscatory in nature, the tribunal would not have considered this factor in *Beck.*



[101] *Beck* (n 13).
[102] 2016 Indian Model BIT (n 4), article 5.3 (a)(ii).
[103] Article 5.3 (b) (i). *See* Peter D. Isakof, 'Defining the Scope of Indirect Expropriation for International Investments' (2013) 3 Global Bus L Rev 189.
[104] Ibid, article 5.3(b)(ii).
[105] Ibid, article 5.3 (b)(iii). Richard R. Baxter et al., *Recent Codification of the Law of State Responsibility for Injuries to Aliens* (Oceana Publications 1974) 52.

In regard with the termination of the Lease Agreement, the Directorate referred to the fact that Mr. Beck failed to comply with the agreement and stated that firms that did not conduct activities would be unilaterally liquidated.[106] From the Directorate's perspective, Mr. Beck violated the Lease Agreement since he developed only a small part of the territory and did not meet the goals and objectives of the activities of the FEZ of Bishkek.[107] In particular, it did not complete Business Park project which was agreed to be built under the Lease Agreement.[108] However, when it was prepared, the Directorate rejected to implement the project on the basis that it was commercial in nature and thus contradicted objectives of FEZ.[109] On the contrary, the justification made by Kyrgyzstan *per se* was against clause 1.3.1 of the Agreement, according to which Beck and Directorate agreed that Beck would carry out commercial activities and the list of activities stipulated in the Lease Agreement was not exclusive but included other activities too.[110] Under article 5.3 (a)(ii), termination of contract could have been construed as the deprivation of the investor from all fundamental attributes of the property and it would have met threshold of a substantial deprivation test.[111]

In line with Article 5.3 (b)(i), termination of the contract would definitely have an adverse economic impact on the investment.[112] Under Article 5.3 (b)(ii) of the Indian Model BIT, measure is permanent since the Directorate unilaterally terminated the contract leaving no chance for Beck to renew his license.[113] Moreover, under Article 5.3 (b)(iv) of the Indian Model BIT, it could have been concluded that Kyrgyzstan violated its written commitments laid in the Lease Agreement to Mr. Beck .[114] Hence, the tribunal most likely would have held



[106] *Beck* (n 13) 4.
[107] Ibid, 12.
[108] Ibid.
[109] Ibid, 12.
[110] Ibid, 26.
[111] 2016 Indian Model BIT, article 5.3 (a)(ii)
[112] Ibid, article 5.3 (b)(i).
[113] Ibid, article 5.3 (b)(ii).
[114] 2016 Indian Model BIT, article 5.3. (b)(iv).

both under Article 5.3 (a)(ii)/sole effects test and under Article 5.3 (b) – which lists several factors, that indirect expropriation took place.[115]

Furthermore, since Kyrgyzstan did not present its position during the procedure there would not have been any evidence or claim that such measures were taken for public purpose. Therefore, it could not have applied a police power exception under Article 5.5. Indian Model BIT favoring Kyrgyzstan's interests, since it requires public purpose and measures to be applied in a non-discriminatory manner.[116] Hence, alternative expropriation clause of the BIT most likely would not have changed the outcome of *Beck* case. If, however, measures had met the minimum standard of being non-discriminatory and pursuing some legitimate aim, the outcome in *Beck* might have been changed.

## 2.2.OKKV v. Kyrgyzstan

### 2.2.1. The outcome of the case under the Moscow Convention

The 2.2 million USD award ruled in favor of 17 CIS investors and their company OKKV LLC, similarly to *Beck v. Kyrgyzstan*, brought under the Moscow Convention and arose out of operations in a Bishkek free economic zone.[117] In particular, the claim has arisen out of the alleged expropriation of a project to build a cultural and accommodation center on the shores of Issyk Kul known as the "Avrora" resort and residential complex.[118]

Remarkably, the construction was financed by way of the conclusion of shared construction participation agreements involving both equity holders from Kyrgyzstan and from Kazakhstan. Hence, on the one hand, the OKKV, as the organization-developer, would use funds raised out

[115] Ibid, article 5.3 (b), 5.3 (a)(ii).
[116] *OKKV* (n 14).
[117] Ibid.
[118] Ibid.

of the investments of individuals from Kazakhstan and Kyrgyzstan for the construction of a tourist complex and on the other hand, the investors would own equity (in the form of cottage/house/apartment) in that complex.[119] Notably, according to Article 8.2 of the Regulation on the procedure and conditions for shared construction (creation) of multi-apartment residential buildings in Bishkek (hereinafter Regulation), participants of a shared construction participation agreement do not acquire an ownership until the completion of the construction and handover of the facility as a whole.[120]

More importantly, the expropriation, within the meaning of article 9 of the Moscow Convention, which took place on the basis of the Decree of the Interim Government of Kyrgyzstan (hereinafter Decree), took place before participants of the shared construction participation agreement have acquired an ownership of equity in that complex.[121] Therefore, OKKV and participants of the agreement alleged that expropriation was internationally wrongful in nature since it not only deprived them of investments but also of the legitimate expectations, that is – the expropriation of the future income of OKKV from investments as well as the expropriation of ownership of a house(cottage) or apartment from equity holders, which were to be built in the territory of the complex.[122]

OKKV and participants of the shared construction participation agreement requested the MCCI to declare an act of expropriation (Decree) illegal and to charge compensation in an amount



[119] Ibid, 5.
[120] Regulation on the procedure and conditions for shared construction (creation) of multi-apartment residential buildings in Bishkek of 27 November 2008 # 20, (hereinafter Regulation), (Prilojenie No. 1 k postanovleniyu Bishkekskogo gorodskogo Kenesha deputatov ot 27 Noyabrya 2008 #20. Polojenie o poryadke i usloviyah dolevogo stroitel'stva (sozdaniya) mnogokvartirnyh jilyh domov v gorode Bishkek), article 8.2.
[121] *OKKV* (n 14), 6. Decree of the Interim Government of the Kyrgyz Republic "On the nationalization of objects of the health-tourist complex Aurora Green" (Dekret Vremennogo Pravitel'stva Kyrgyzskoj Respubliki o nacionalizacii objektov ozdorovitel'no-turisticheskogo kompleksa "Avrora Green") of 19 July 2010 # 99 (with latest amendments of 28 September 2010 # 130").
[122] Ibid.

determined by the MCCI but not less than 2.343.862,00 USD (a total amount invested by the equity holders).[123]

With respect to the expropriation issue, the tribunal referred to Article 9 of the Moscow Convention.[124] It concluded that the term "expropriation" was applied by Claimant in a broad sense, implying that the nationalization is one kind of expropriation.[125] The tribunal applied Seoul Convention to define expropriation as it already did in *Beck v. Kyrgyzstan*. Notably, Claimant's view was that the Seoul Convention was the only source containing explanation of expropriation at that time.[126]

Having considered the Decree, a tribunal concluded that violation of investor's right within the meaning of Article 9 of the Moscow Convention took place.[127] Regrettably, Kyrgyzstan disregarded letters and notifications of Claimant and of the tribunal, hence Kyrgyzstan voluntarily lost its right to participate in determining the time and place of the proceedings, electing the composition of the arbitral tribunal and its other procedural rights, as was shown in case *Beck v. Kyrgyzstan*.[128] Accordingly, all these issues were resolved without the participation and consideration of the interests of the Kyrgyz Republic.

In accordance with Article 9 of the Moscow Convention[129], under which nationalization cannot be executed without provision of an adequate compensation to the investor, and in line with article 12(2) of the Constitution of Kyrgyz Republic[130], under which any forced seizure of property presumes compensation to the owner, the tribunal held that the Decree was wrongful act, which contradicted the Constitution of Kyrgyz Republic as well as breached an



[123] Ibid, 8.
[124] Ibid.
[125] Ibid.
[126] Ibid, 17.
[127] Ibid.
[128] Ibid.
[129] Moscow Convention (n 10), article 9.
[130] Constitution of Kyrgyz Republic (Konstituciya Kyrgyzskoj Respubliki) of 2010 # 218 (with latest amendments of 11 December 2016 # 218), article 12(2).

international obligation taken by the Kyrgyz Republic.[131] Therefore, the tribunal ordered Kyrgyzstan to pay compensation in an amount of 2.343.862,00 USD.[132]

In *OKKV*, just like in *Beck*, there is no too much analysis about the expropriation clause and application of it to the facts. What can be noticed from both cases is that the tribunal just affirmed Claimant's position that the events taken place deprived control over the investment and economic value of it, even not taking into consideration the public aim behind the regulatory measure. Certainly, the public purpose behind the Decree on nationalization of Avrora Green in this case was impossible to determine due to the absence of Kyrgyz Republic in the proceedings, and thus the tribunal only considered the investor's view and position on the issue of expropriation, which was construed in a way that reflected violations and benefited investors' interests.

### 2.2.2. The possible outcome of the case under Indian Model BIT

One of the changes that Article 5 Indian Model BIT would have established, should it be applied by the tribunal, it would be the definition of indirect expropriation. Unlike Article 11 (a)(ii) Seoul Convention[133] and Article 9 of the Moscow Convention[134] applied by tribunal in both cases, Article 5.3 (a)(ii) Indian Model BIT dedicates a separate provision to define indirect expropriation and under Article 5.3 (b) it lists several factors determining whether indirect expropriation constituted or not.[135] However, if Article 5 Indian Model BIT had been applied by the tribunal, it would have had difficulties as to which test to apply: sole effects test under Article 5.3 (a)(ii) based only on the seriousness of the effect on the investment, police powers test under Article 5.5 benefiting primarily host state or proportionality test under Article 5.3

[131] *OKKV* (n 14) 24.
[132] Ibid, 25.
[133] Seoul Convention (n 12), article 11(a)(ii).
[134] Moscow convention (n 10), article 9.
[135] 2016 Indian Model BIT, article 5.

(b) which includes consideration of both the purpose behind the measure and its effect on an investment.[136]

Should Article 5.3 (a)(ii) of the Indian Model BIT[137] be applied by the tribunal, the outcome would be the same as under Article 9 of the Moscow Convention[138]. The reason is that both Article 11(a)(ii) of the Seoul Convention (since it was applied by the tribunal in the light of absence of meaning expropriation in MC) and Article 5.3 (a)(ii) Indian Model BIT require the deprivation of the investor of right to control or a benefit from such an investment. According to literal interpretation of the Seoul Convention there must be a deprivation of ownership as well as control and the wording "substantial" is attributable only with respect to the deprivation of income.[139] Whilst under Article 5(a)(ii) Indian Model BIT, the deprivation must be substantial in respect to all "fundamental attributes of property including right to use, enjoy, control and dispose of investment" not including the formal seizure of ownership.[140] Accordingly, even if 11 (a)(ii) of the Seoul Convention only requires substantial deprivation of an income over such investment and Article 5 (a)(ii) Indian Model BIT requires substantial deprivation of all attributes of property, the Decree nationalizing the investments made by OKKV and co-investors could have been construed as the state measure substantially depriving them of the "fundamental attributes" of investment.[141]

With respect to the deprivation of control, under Article 6 of the Decree, the execution of necessary measures including registration of the nationalized objects was under control of the Chief of Interim Government, hence, the control over the investment was transferred to Interim

[136] Ibid, article 5. *See* also Ranjan (n 5) 34.
[137] 2016 Indian Model BIT, article 5.3 (a)(ii).
[138] Moscow Convention (n 10), article 9.
[139] Seoul Convention (n 12), article 11 (a)(ii).
[140] 2016 Indian Model BIT, article 5.3 (a)(ii).
[141] Ibid, article 5.3 (a)(ii).

Government of Kyrgyzstan.[142] As regards to the deprivation of an income and other fundamental attributes of property, in line with Article 3 of the Decree, OKKV's certificate of temporary use of land in the territory of Aurora Green was annulled, which deprived the OKKV of a substantial income from its investments and its co-investors of their ownership.[143] In particular, since at the time of the entry into force of the Decree, OKKV had only finished 80% of the construction, the Decree deprived of ownership of the co-investors because formal transfer of ownership (cottage/house) was possible only upon the completion of the construction under the Regulation.[144] In addition to it, OKKV was deprived of its future income from such investments on the basis of the Decree. Finally, according to the facts of the case, co-investors themselves took the necessary amount on credit, for which interest had been charged.[145] Accordingly, co-investors lost not only the amount that was transferred to the OKKV, but also accrued interest.[146]

With respect to Article 5.3 (b) Indian Model BIT, according to Anand Pushkar and Prabhash Ranjan, even if it does not explicitly mention the proportionality test, the factors listed, as such, establish proportionality test under which not only economic impact but also the legitimate public purpose underlying the state measures must be taken into account.[147] The economic impact under Article 5.3 (b)(i) has already been addressed in a substantial deprivation of income of investments made by OKKV and deprivation of ownership from its co-investors.[148] Concerning the duration under Article 5.3 (b)(ii) Indian Model BIT, duration could have been



[142]Decree (n 121), article 6.
[143] Ibid, article 3.
[144] Ibid. Regulation (n 120), article 8.2.
[145] *OKKV* (n 14) 18.
[146] Ibid.
[147] Ranjan (n 5), 34; Benedict Kingsbury et al., 'Public Law Concepts to Balance Investors' Rights with State Regulatory Actions in the Public Interest – The Concept of Proportionality' (2010) OUP 76; Andreas Kulick, *Global Public Interest in International Investment Law* (1st edn, CUP 2012).
[148] 2016 Indian Model BIT, article 5.3 (b)(i).

construed as permanent since the Decree did not leave any chance to OKKV to restore control and benefit from his investments and deprived the co-investors of their ownership in the form of cottage/house for which they made investments into OKKV. Under Article 5.3 (b)(iii), the character of the Decree must be taken into account. In this respect, the decision rendered by the Constitutional Chamber of Supreme Court of Kyrgyzstan must be considered.[149]

Before initiating arbitration proceedings, OKKV together with other legal entities, whose investments were nationalized, requested the Constitutional Chamber to recognize the decrees on nationalization taken by the Interim Government of Kyrgyzstan in 2010 unconstitutional.[150] The Constitutional Chamber held that the Decrees did not fall within its jurisdiction since they cannot be qualified as normative legal acts, and thus did not consider the constitutionality of the Decrees.[151] The Chamber held that in cases where the rights and legitimate interests of individuals and legal entities were breached, their legal claims should be considered by the competent state authorities and that any restrictions related to private property rights should be justified and proportionate to legitimate goals and that they must be accompanied with compensation.[152] According to the Chamber, the seizure of property from private owners on the basis of the Decree on Nationalization was an exceptional measure, due to the extraordinary situation and the presence of special need.[153] Hence, the Decree pursued some legitimate aim which was the stabilization of the socio-political situation, overcoming the critical state and socio-political tensions, ensuring the rule of law, security of the state and the population, that is, in general, managing the state at a crucial moment in order to overcome the socio-political

[149]Decision of the Constitutional Chamber of the Supreme Court of the Kyrgyz Republic (Reshenie Konstitucionnoi Palaty Verhovnogo Suda Kyrgyzskoj Respubliki) of 11 July 2014 # 37-r.
[150] Ibid.
[151] Ibid.
[152] Ibid.
[153] Ibid.

crisis.[154] While the Constitutional Chamber held that the Decrees, indeed, pursue some legitimate aim, the Claimant (OKKV) argued that the true reason was the fact that nationalized properties of all persons and entities allegedly had link to the former president – Kurmanbek Bakiev.[155]

To begin with, the Decree was adopted on the basis of submissions of the General Prosecutor of Kyrgyzstan including those against the former President.[159] The ex-President was accused of committing massacres in April 2010 and for committing other crimes.[160] Hence, it can be concluded that the character of the measure (Decree) under Article 5.3(b)(iii) was confiscatory i.e. a criminal sanction against ex-President. Such confiscations do not usually constitute expropriation.[161] Assuming that Kyrgyzstan would have provided evidences proving that properties of co-investors of OKKV had link with ex-President, nationalization of such properties would most likely not amount to expropriation. However, numerous inspections and investigations did not establish any connection between OKKV and the ex-President of the Kyrgyz Republic - Kurmanbek Bakiev, his family or close associates.[162] Moreover, the criminal cases initiated against officials of the executive departments of the President of the Kyrgyz Republic and the State Enterprise "Issyk-Kul Aurora Sanatorium" were terminated due to lack of corpus delicti.[163] Employees of LLC OKKV and co-investors were not prosecuted, as stated in the certificate of the Prosecutor General.[164]

[154] Ibid.
[155] *OKKV* (n 14) 17.
[159] Decree (n 121).
[160] Asylkhan Mamashuly, 'Kurmanbek Bakiev sentenced to life imprisonment' (Radio Azattyk 25 July 2014) < https://rus.azattyq.org/a/kurmanbek-bakiev/25470319.html> accessed 30 May 2020.
[161] Richard (n 105).
[162] Tolgonai Osmongazieva, 'The nationalization of absurdities' (Nacionalizaciya nesuraznostej) (2012) <https://24.kg/archive/ru/biznes-info/125482-nacionalizaciya-nesuraznostej.html/> accessed 24 May 2020.
[163] Ibid.
[164] Ibid.

Accordingly, if there were no evidences that nationalized properties had link with the former President, the necessity of such a radical measure – nationalization of properties must be assessed. In this respect, footnote 6 to Article 32 of the Indian Model BIT states that whether non-discriminatory measures are necessary to achieve public purpose objectives, such as maintaining public order[165], depends on "whether there was no less restrictive alternative measure reasonably available to a Party"[166]. The meaning of "necessary" is given in a way that it restricted its scope, and thus the tribunal would only assess whether the same objective can be achieved using a less restrictive regulatory measure reasonably available to the state.[167] Hence, there would be no weighing and balancing of the effect of the measure in relation to the object and purpose of the measure.[168] Since the Indian Model BIT has already indicated how to determine the necessity of the measure in light of its objective, the decisive question in this case would be whether there were less restrictive measures to achieve stabilization of socio-political regime in Kyrgyzstan other than nationalization of properties of all who had or allegedly had relationships with ex- President of Kyrgyzstan.

Certainly, stabilization of socio-political regime is vital but whether such an aim could be achieved with deprivation of ownership of co-investors in OKKV and deprivation of control and future income of OKKV is doubtful. If, ultimately, co-investors of OKKV did not have any relation with ex-President, then how would it help to restore public order? If there was a link, then the measure would have been a confiscatory measure against the former President necessary to preclude future violations of ex-President.



[165] This paper considers that stabilization of socio-political regime is a way to restore public order – one of the established legitimate public purpose objectives under the BIT.
[166] 2016 Indian Model BIT, footnote 6 to article 32.
[167] Ranjan (n 42) 33.
[168] Ibid.

Nonetheless, Article 5.5 of the BIT restricts the constitution of expropriation provided that the state measures are non-discriminatory and pursue some legitimate aim.[169] With respect to non-discriminatory requirement, not only the territory of "Aurora Green" but also enterprises such as Tashkomur LLC, Kant cement plant, Guesthouse Vityaz were subject to nationalization on the basis of the Decree taken by the Interim Government of Kyrgyzstan in the same year.[170] The measures taken by the Interim Government were not discriminatory to OKKV since the nationalization took place with respect to other industries as well. Moreover, it pursued legitimate aim which is even confirmed by the decision of the Constitutional Chamber of the Supreme Court of Kyrgyzstan.[171] Accordingly, Kyrgyzstan could have referred to a police power exception under Article 5.5 Indian Model BIT and counter claim that the measures pursue legitimate aim and were non-discriminatory in respect to OKKV and provide evidences confirming that statement. It would most likely have met the threshold of a police power exception.

Hence, if Kyrgyzstan presented its position before the tribunal, it could have had chance to refer to a police power exception under Article 5.5 Indian Model BIT.[172] However, difficult questions might have arisen relevant to public purpose. In the case at hand, OKKV mentioned the purpose underlying the Decree was to confiscate the properties of those who had relations with ex-President of Kyrgyzstan, while according to the decision of Constitutional Chamber, the Decree was adopted in the light of political crisis in order to stabilize the socio-political regime in Kyrgyzstan. Hence, the application of only expropriation rule under the Indian Model BIT would have barely changed the outcome of the case. However, it would at least have



[169] 2016 Indian Model BIT, article 5.5.
[170] Decree (n 121).
[171] Decision of 11 July 2014 # 37-r (n 149).
[172]2016 Indian Model BIT, article 5.5.

provided Kyrgyzstan a chance to protect its interests under police power exception even if not necessarily win the case.

## 2.3.Sistem v. Kyrgyz Republic

### 2.3.1. The outcome of the case under Kyrgyz-Turkish BIT

Similar to *OKKV v. Kyrgyzstan*, the circumstances of the *Sistem* case involve revolution and a regime change.[173] The circumstances of the case of *OKKV* took place during the revolution in 2010 against the second ex-president Kurmanbek Bakiev, whilst the circumstances of *Sistem* case took place in 2005 during the revolution against the first ex-president Askar Akaev.[174] Unfortunately, from both cases one can notice the instability of not only legal regime which was the case in *Beck v. Kyrgyzstan* (taxation instability) but also of a political regime.

Although the Sistem's Case was initiated back in 2005, until July 2006, the Kyrgyz Republic did not respond to letters and notifications from Sistem and the ICSID.[175] As a result, without the participation of the Kyrgyz Republic, the time and place of the arbitration was determined and the composition of the arbitration tribunal was selected without consideration of the interests of Kyrgyzstan.[176]

As regards the factual background, in the early 1990s, the Turkish company "Sistem Muhendislik Inshaat Sanain ve Tijaret A.Sh." (hereinafter Sistem) and Kyrgyz closed joint stock corporation Ak-Keme (hereinafter Ak-Keme) have created the Ak-Keme-Pinara joint

[173] *Sistem* (n 15).
[174] Ibid.
[175] Ibid, § 6.
[176] Ibid, § 9.

venture to implement an investment project for the construction and further joint operation of a 4-star international hotel with 400 places in Bishkek.[177] The hotel was officially opened on August 28, 1995, but by that time, the relations between partners have become worse, presumably due to the Turkish side's failure to fulfill its obligations under the agreement.[178] In 1996, Sistem's licenses for foreign investment and construction were revoked.[179] In 1998, the judicial authorities of the Kyrgyz Republic declared Ak-Keme bankrupt.[180] Consequently, the special administrator of Ak-Keme restructured Ak-Keme by creating an independent legal entity to which all assets of Ak-Keme, including the hotel itself, were transferred but liabilities were not transferred.[181]

In 1999, as a result of negotiations, agreements including the General Agreement were concluded between the Government of the Kyrgyz Republic, Sistem and the special administrator of Ak-Keme.[182] Under the 1999 General Agreement, Sistem acquired a 100% stake in the authorized capital of the newly created legal entity, and as such, became the sole owner of the hotel.[183] Notably, the General Agreement clearly reflected the protection of investments guaranteed under the BIT between Kyrgyzstan and Turkey regarding mutual assistance to investments and their protection of April 28, 1992.[184]

In October 2002, a number of Kyrgyz citizens initiated proceedings before the Constitutional Court of Kyrgyzstan against Sistem to repeal acts of the High Commercial Court on declaring Ak-Keme bankrupt in 1998.[185] On December 17, 2002, the Constitutional Court of the Kyrgyz

[177] Ibid, § 27, 29.
[178] Ibid.
[179] Ibid, § 46, 48.
[180] Ibid.
[181] Ibid, § 49, 54
[182] Ibid, § 53
[183] Ibid, § 51, 54
[184] Ibid § 61.
[185] Ibid, § 87.

Republic decided to recognize the decision of the High Commercial Court unconstitutional and, thus unenforceable.[186] However, from 1999 to 2005, Sistem remained as the actual owner of the hotel.[187] On March 25, 2005, during the revolution when the law enforcement agencies were weakened, an armed group of approximately 50 people, led by a local former chairman of Ak Keme, Mr. Sarymsakov seized the hotel with the aim to protect it from marauders.[188] Consequently, the full control over the hotel passed to the Joint Kyrgyz-Malaysian Enterprise "Ak-Keme Hotel".[189]After a series of unsuccessful attempts to take back the hotel and complete disregard on the part of the Kyrgyz Republic, Sistem initiated an arbitration proceeding against Kyrgyzstan.

With respect to expropriation issue, a tribunal considered deprivation of control in the hotel as a matter of fact since, on 25 March 2005, fifty people led by the former chairman of Ak-Keme - Mr. Sarymsakov, physically took control over the hotel presumably because they could have protected the hotel from marauders. [190] Further, the tribunal considered a judicial decision invalidating the Share Purchase Agreement as the abrogation of contractual rights of Sistem, i.e. deprivation of its property rights in the hotel as a matter of law.[191] According to the tribunal, the same effect could have been established in the case where the State had expropriated investment by a decree.[192]

In respect of deprivation of Sistem's interest in the hotel, the tribunal viewed it in two ways: deprivation viewed in theory and the actual abolishment of legal interest in the hotel.[193] The

[186] Ibid.
[187] Ibid, § 76.
[188] Ibid, § 97.
[189] Ibid.
[190] Ibid, § 122.
[191] Ibid.
[192] Ibid, § 118
[193] Ibid, § 123.

tribunal concluded that theoretically Sistem had only lost 50% interest in the hotel. The reason was that in 1999 it become the sole owner of the hotel in return for future payments of 50% of its profits up to a total of 12.7 million USD, until such time as the 12,700,000 million USD debt was repaid to the liquidator of Ak keme and Kyrgyz Government.[194] In lieu, the tribunal also gave regard to the fact that neither Ak keme nor newly incorporated Ak keme Hotel Joint Kyrgyz Malaysian Enterprise considered that Sistem kept any interest in the hotel by late June 2005.[195]

The tribunal applied Article III Kyrgyz-Turkish BIT under which a lawful expropriation requires provision of adequate, prompt and effective compensation, public purpose and that the measures must be taken in a non-discriminatory manner and followed by due process of law of the host state.[196] The tribunal found that adequate, prompt and effective compensation was not provided, however it did not discuss other conditions.[197] It based its award on compensation on the grounds that Sistem "had no longer legal interest in the hotel".[198] The tribunal held that whether the State benefited from taking or took possession of the hotel were irrelevant but rather applied substantial deprivation test and held that Sistem had been deprived by the act of the State, which considered as a breach of Article III Turkish-Kyrgyz BIT.[199]

[194] Ibid, § 54.
[195] Ibid, § 124.
[196] Turkish-Kyrgyz BIT (n 11), article III.
[197] Ibid, § 119.
[198] Ibid, § 129.
[199] Ibid, § 119.

### 2.3.2. The possible outcome of the case under Indian Model BIT

According to Article 5.3 (a)(ii) of the Indian Model BIT, indirect expropriation is established if it substantially deprives the investor of its fundamental attributes of the investment.[200] Presumably, if this provision had been applicable to *Sistem* case, the tribunal would have considered the effect of the judicial decision invalidating Share purchase agreement on the investment made by Sistem in the hotel. Sistem became the sole owner in line with 1999 Agreements, including Share Purchase Agreement. However, in fact it only owned 50 % interest in the hotel since it had to pay 50 % of profits to the liquidator of Ak keme and Kyrgyz Government.[201] Arguably, the district court's decision invalidating the 1999 Share Purchase Agreement deprived the whole 50% interest in the hotel and thus would have been equivalent to expropriation. Moreover, that decision was upheld by the Supreme Court of Kyrgyzstan which excluded Sistem's chance to appeal in order to return its interest in the hotel.[202] Furthermore, it substantially deprived of not only the interest in the hotel but also control as it was physically taken by the former chairman of Ak Keme during revolution in 2005.[203]

Further, Article 5.3 (b) of the Indian Model BIT lists factors such as economic impact of the measures on the investment, duration of the state measures, character and prior written commitments to the investor.[204] According to Benedict Kingsbury, the length of interference is taken into consideration under the proportionality test together with other factors such as "the importance of the right affected, the importance of the right or interest protected, the degree of interference (minor versus major interference), the availability of alternative measures that

[200] 2016 Indian Model BIT, article 5.3 (a)(ii).
[201] *Sistem* (n 15) 54.
[202] Ibid, § 112.
[203] Ibid, § 97.
[204] 2016 Indian Model BIT, article 5.3(b).

might be less effective, but are proportionally less restrictive for the right affected".[205] These factors are also stipulated in Article 5.3 (b) (iii) Indian Model BIT, as the object, context and intent of the state measures.[206] However, the character and nature of the measure under Article 5.3 (b)(iii) would not have been considered by the tribunal merely because these factors are only relevant when the state measure is confiscatory, which was not the case in *Sistem*.[207]

Under this approach, economic impact of the judicial decision on Sistem's investment has been met as already been discussed above while examining the substantial deprivation test. With respect to the length of interference, in 17 June 2005 Inter-district Court made a judgment invalidating the bankruptcy of Ak-keme of 14 May 1997 and ordered restitution, i.e. the parties to be brought to their initial position under which "movable, real estate, turnaround and money resources and other assets to be transferred to Ak Keme".[208] This decision was contradictory to the decision of the High Commercial Court who recognized Ak Keme bankrupt first in October 1998 and in December of the same year.[209] Further, the district court in June 27, 2005, found that the 1999 Share Purchase Contract was void which was upheld by the Appellate and Supreme courts of Kyrgyzstan.[210] It must be noted that the judicial decision on invalidation of 1999 Share Purchase Agreement is interconnected to the judicial decision invalidating the hotel's bankruptcy since the court deciding on invalidity of the Share Purchase Agreement based its decision the fact that Ak Keme was not bankrupt by that time.[211] Hence, the duration of the measures is permanent.

[205] Kingsbury (n 147) 87.
[206] 2016 Indian Model BIT, article 5.3 (b)(iii).
[207] Ibid. Richard (n 105).
[208] Case No. B-400/4, Judgement, Bishkek Interdistrict Ct., June 17, 2005, RCM 47.
[209] Ibid. *Sistem* (n 15) § 89.
[210] Decision, Leninskiy District Ct. of the City of Bishkek, June 27, 2005, RCM 48.
[211] Ibid, § 27.

As regards the factual matter - physical takeover of control of the hotel by the former chairman of Ak Keme, under Article 5.3 (b) (ii), it can be considered as permanent, since it occurred in March 25, 2005 and lasted until April, 2005 - when the former chairman of Ak Keme has already established a new Kyrgyz-Malaysian joint venture to operate the hotel together with a Malaysian company.[212]

Under Article 5.3 (b) (iv) Indian Model BIT, prior binding written commitments to the investor in the form of contracts or licenses also relevant factor.[213] In *Sistem* case, Sistem, the liquidator of the hotel Ak-Keme and the Government of Kyrgyzstan concluded the 1999 Agreements including Share Purchase Agreement, according to which Sistem was the sole owner of the hotel.[214] According to Kyrgyzstan's perspective, the 1999 Agreements were invalid because of the Sistem's failure to provide evidence of its payment obligations.[215] On the contrary, in *Sistem* case, the tribunal held that "a failure to perform a contractual obligation may breach the contract but it did not render the contract void *ab initio*; if it were otherwise, no party in breach could ever be held liable for the breach of contract."[216] Indeed, Kyrgyzstan itself breached its contractual obligations by depriving Sistem from the property rights in his investment. Hence, prior commitments to the investor were also breached by Kyrgyzstan.

With respect to the public purpose under Article 5.5 of the Indian Model BIT, the measures in *Sistem* case did not pursue any legitimate public purpose.[217] At the case at hand, state's measure was in the form of a judicial decision invalidating the Share Purchase agreement and in state's omission laid in ignorance with respect to the unlawful physical control takeover in the hotel.

[212] Ibid, § 99.
[213] 2016 Indian Model BIT, article 5.3 (b)(iv).
[214] *Sistem* (n 15) § 27.
[215] Ibid.
[216] Ibid, § 73.
[217] 2016 Indian Model BIT, article 5.5.

First, physical takeover of control was in nature illegal and illegitimate and against the national law of Kyrgyzstan, i.e. Article 19.2 of the Constitution which prohibited the seizure of property rights unless by a court decision.[218] Second, the judicial decision invalidating bankruptcy of Ak keme and requiring restitution was based on the sole evidence - letter to the President of the Kyrgyz Republic from the Department of Economic Policy of the Office of the President, which stated that at that time Ak-Keme was solvent, profitable and had no debts to the budget of the Kyrgyz Republic.[219] Third, the district court's decision invalidating the Share Purchase agreement was based on the decision of the Bishkek Inter-district Court annulling the bankruptcy of Ak-Keme and thus did not pursue any legitimate public purpose.[220] Hence, if there was no legitimate public purpose underlying the judicial decision and physical takeover, Kyrgyzstan would not have been guarded by a police power exception.[221]

Finally, Article 5.6 Indian Model BIT provides that the investors must pursue actions for remedies before domestic courts or tribunals before bringing a claim under Indian Model BIT.[222] Sistem tried several times to appeal the courts' decisions invalidating the Share Purchase Agreement but did not succeed and thus this condition would have been met on part of Sistem. Thus even if Article 5 Indian Model BIT have been applied, the outcome would not have been changed.

Indeed, it is difficult to predict the outcome of the case which includes participation of Kyrgyz authorities from all branches of power of Kyrgyzstan including even the President of Kyrgyzstan and taken place during the revolution against the first former President of

[218] Constitution (n 130), article 19.2.
[219] *Sistem* (n 15) § 106.
[220] Ibid, § 27.
[221] 2016 Indian Model BIT, article 5.5.
[222] Ibid, article 5.6.

Kyrgyzstan – Askar Akaev. Furthermore, marauding taken place during that revolution were the justification for a *de facto* deprivation of control over the hotel.[223] Hence, the only application of the alternative expropriation clause under Indian Model BIT would have barely changed the outcome of *Sistem* case.

[223] *Sistem* (n 15) § 97.

## Conclusion

As has been discussed above, the current expropriation clause under Article 5 of the Indian Model BIT encompasses state-friendly policy.[224] First, Article 5.5 of the BIT excludes the establishment of expropriation provided that the states' regulatory measures and judgements are aimed to protect public interests and applied in a non-discriminatory manner.[225] Accordingly, even if the impact of the regulatory measures is "manifestly excessive" or disproportionate, they will not constitute expropriation as far as the measures meet the minimum threshold of being non-discriminatory and aiming to fulfil public purpose objectives.[226]

Had Kyrgyzstan provided its position on the expropriation claims and construed it in a way that the measures fulfill the condition of aiming to achieve public welfare, Article 5.5 Indian Model BIT would have helped Kyrgyzstan to protect its interests, in particular in *OKKV* case. However, the decision of the Constitutional Chamber, which confirmed the presence of a legitimate public aim , that was stabilization of the socio-political regime in Kyrgyzstan, was not even presented to the tribunal. Nor there were presented evidences that OKKV had relations with the ex-President of Kyrgyzstan. If they were provided to the tribunal, most probably Article 5.5 Indian Model BIT would have served positively for interests of Kyrgyzstan.

Second, Article 5.6 of the Indian Model BIT requires foreign investors, first, to exhaust domestic remedies before initiating arbitration.[227] In this respect Article 15 of the BIT requires the foreign investor to exhaust domestic remedies "within 6 years at the moment when he, first,

[224] Ranjan (n 42) 33.
[225] 2016 Indian Model BIT, article 5.5.
[226] Ranjan (n 5) 33.
[227] 2016 Indian Model BIT, article 5.5.

acquired or, first, should have acquired knowledge about the measure in question."[228] Then the parties must attempt to reach an amicable settlement during 6 months and after give notice of arbitration within 90 days.[229] The imposition of exhausting local remedies supplemented with third party procedures make difficult to investors to initiate arbitration proceedings against host states. Hence, it does not strike a balance between the interests of host states and investors. It would have struck the balance between the right to regulate and protection of investors in the context of expropriation, if it provided an opportunity for investors to challenge regulatory measures but only when the impact of such measures are "manifestly excessive in light of its purposes".[230]

Notwithstanding the state-friendly approach so as to shrink the scope of investment claims brought against states, the expropriation clause under Article 5 of the Indian Model BIT is precise and instructable on the notion of indirect expropriation. Although, it creates "muddy of tests"[231] resulting in a wide judicial discretion that may reduce predictability and security, at the same time Article 5.3 (b) requires a case-by-case analysis that allows tribunals to apply a specific test to a particular case depending on the circumstances of the case. Despite the fact that alternative expropriation clause of the Indian Model BIT would not have changed the outcome of expropriation cases, at least it would have provided Kyrgyzstan an opportunity to defend its interests based on police power doctrine. Moreover, by imposing limitations on timeframe and requiring to amicably settle the dispute, the Indian Model BIT shrinks the scope of future expropriation claims to be brought against host states. Thus, it might help Kyrgyzstan to preclude future expropriation claims.



[228] Ibid, article 15.5.
[229] Ibid, article 15.4.
[230] Comprehensive Economic and Trade Agreement Between Canada, of the one Part, and the European Union and its Member States, of the Other Part S.C. (signed in 30 October 2016, entered into force 21 September 2017), annex 8-A(3).
[231] Ranjan (n 5) 33.

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