5

Foreign Firms and Their Diplomats in Ukraine

At first glance, Ukraine is the kind of country with little choice but to adhere to the contracts it forms with foreign firms. For sure, protest and sometime violence has rocked Ukraine in the 2000s and 2010s. But the government has considerable incentives to keep those actions separate, to the extent possible, from the treatment of foreign firms. Endowment-based explanations for a government's propensity to break contracts would predict breach in resource-rich Venezuela or a country with a large market like China. Ukraine shares neither of these traits. Rather, Ukraine competes for global capital against many possible destinations, making it the kind of country for which the need for contract sanctity has gone without question. Moreover, multilateral institutions have scrutinized Ukraine and its market economy for progress in economic and political transition since its independence in 1991, making international pressure to comply with property rights protections all the stronger. As a regular recipient of International Monetary Fund (IMF) loans, Ukraine has agreed to limit its policy freedom in order to maintain the sanctity of its sovereign bondholders' contracts. One might reasonably expect that a government under the scrutiny of both global market actors and the IMF would want to uphold its commitments to other sources of capital – including commitments made to foreign direct investors. Indeed, Ukraine has taken steps to establish credible commitments to foreign firms by signing sixty-eight bilateral investment treaties (BITs), fifty-five of which are in force as of 2013.[1] These BITs codify the security of foreign firms' property and their recourse to international law.

Nevertheless, the Ukrainian government sometimes engages in public contract disputes with foreign firms, and it sometimes breaks those contracts. Even the 2005 Orange Revolution government, heartily celebrated by Western commentators for its stance in favor of economic openness, broke contracts. Ukraine increased its commitment to contract sanctity after the Orange government's collapse and through the early 2010s, despite the turbulence of subsequent Ukrainian politics.

As Ukraine's fortunes have waxed and waned in its history as an independent country, so too has Ukraine's FDI national diversity varied as different nationalities of foreign firms have entered and exited. Ukraine is therefore an important setting in which to trace the effects of changes in the diversity of investor nationalities on the incidence of government breach of contract. Ukraine's FDI national diversity breaks down into two periods: high and increasing in the late 1990s through the early 2000s, and lower and relatively stable after about 2004 through the early 2010s. In this chapter, I connect the first period to multiple broken contracts with US and other investors. In the second period, the Ukrainian government repaired a long outstanding breach with a US investor, refrained from breach with a Norwegian investor, and canceled a threatened breach with Russian investors.

[1] UNCTAD, as of 1 June 2013.

Finally, the chapter takes advantage of Ukraine as a setting in which to explore additional questions raised by the nationality shield theory. I demonstrate that foreign firms' national resources are integral to breach deterrence even when there is a common threat of breach. Additionally, firms with claims on more than one home country take advantage of their multiple national resources – in particular, their diplomats.

UKRAINE'S FDI NATIONAL DIVERSITY

Figure 5.1 plots a measure of Ukraine's FDI national diversity alongside FDI national diversity in Russia, which serves as a reference point. This measure, the variable used in quantitative analyses in Chapter 4, grows rapidly from the 1990s through the early 2000s and then slowly declines after about 2004. These trends contrast with neighboring Russia, reinforcing the notion that FDI national diversity varies from country to country. Change over time in OECD-origin FDI national diversity in Ukraine sets up a difficult test for the nationality shield theory. Though OECD-origin firms are the ones most often thought of as stateless actors, the evidence presented in this chapter must demonstrate that even these firms' nationalities matter for contract sanctity. In a period of rapidly

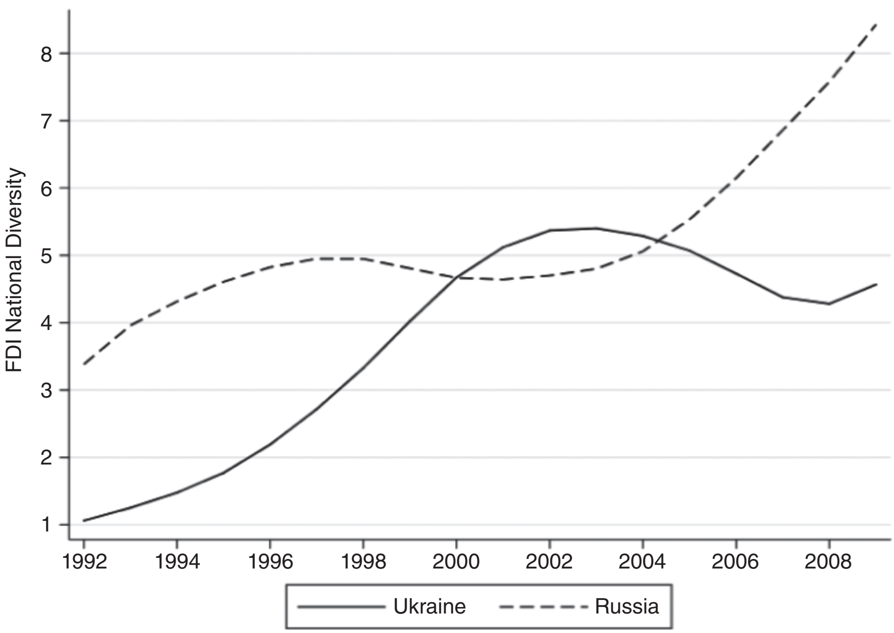

FIGURE 5.1 **FDI National Diversity in Ukraine as Compared to Russia**
Lowess-smoothed OECD-origin FDI stock national diversity measures (see Chapter 4 for calculation details).

increasing FDI national diversity, the Ukrainian government should be likely to break contracts instead of avoiding breach or settling with foreign firms: the country is gaining access to new sources of FDI that are relatively indifferent to any other nationality's contract breach. With the change in the FDI national diversity trend, Ukraine's propensity to break contracts should drop in the mid-2000s. One way to observe this is to see contract disputes avoided or settled rather than mired in conflict. In short, while the diversity of investors present in Ukraine rose, peaked, and lowered, foreign firms' abilities to deter contract breach are expected to move in the opposite direction. Indeed, reflecting on Ukraine's trajectory, the well-positioned local head of a foreign private equity firm summed it up in 2011: "the biggest disputes in Ukraine happened before and through 2004."[2]

Sources of Variation in FDI National Diversity

In the first period of Ukraine's history as an independent country, the unexpected break-up of the Soviet Union left governments scrambling to gain a foothold in it and other newly sovereign countries. As one means to this end, governments promoted their nationals' investments in Ukraine as well as the broader region. For example, the US government supported investment through programs at the Department of Defense, the Nuclear Regulatory Commission, the Department of Agriculture, the Ex-Im Bank, the US Agency for International Development, the Department of Commerce's Business Information Service for the Newly Independent States (BISNIS), and more.[3] European investors also benefitted from a wide array of national programs and European-Union-wide efforts. Additionally, a new class of Western entrepreneurs became "cowboys," running small- and medium-sized enterprises in what came to be called "the Wild East." Foreign firms invested in Ukraine's traditional strengths in agriculture and heavy industry as well as in manufacturing, finance, and retail.[4]

US firms accounted for the largest proportion of Ukraine's FDI stock throughout the 1990s, but by 2003, a variety of Western and Eastern European investor nationalities had begun to catch up (see Figure 5.2). Ukraine benefitted from the economic success of transition countries in Central Europe, many of which were in final preparations to join the European Union on 1 January 2004. As the reform process had begun to raise costs in those countries, and accession to the European Union would make investments in those countries fully subject to EU standards,

[2] Interview, foreign firm in financial services, Ukraine, 2009.

[3] See for example the "Report on the implementation of the humanitarian and technical assistance program to the New Independent States of the former Soviet Union," US Senate, 102nd Congress, 29 October 1992.

[4] WIIW Database on Foreign Direct Investment in Central, East, and Southeast Europe (2009).

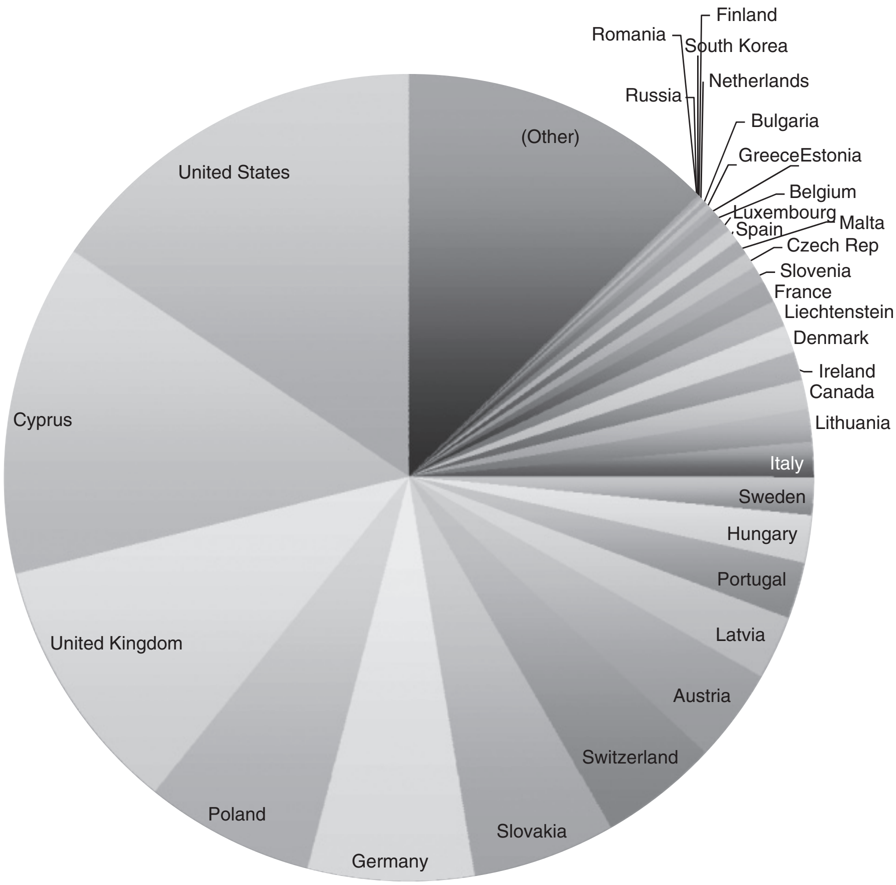

FIGURE 5.2 **FDI Nationality Distribution in Ukraine** (2003)
Source: Vienna Institute for International Economic Studies (WIIW), Database on Foreign Direct Investment in Central, East, and Southeast Europe, 2009 Release.

Western European investors began moving further eastward in search of low wages and low-cost inputs. Central European firms from Ukraine's neighbor Poland as well as Slovakia, Latvia, and Hungary also joined the movement eastward. New investments flowed into industries like banking and light manufacturing, which made use of Ukraine as an export platform to the EU.[5]

Russian investors quickly entered and grew their investments in Ukraine, a country with a long shared history with Russia and a sizeable Russian minority.[6]

[5] Interviews (2), foreign firms in consumer goods and finance, Ukraine, 2009.

[6] In the 2001 Ukrainian census, Ukraine's population was 17 percent Russian ethnicity and 77 percent Ukrainian ethnicity. Russian is widely spoken; prominent politicians are sometimes poor Ukrainian speakers.

In particular, Russians were ready participants in Ukraine's privatization processes. As was true in all post-communist countries, assets big and small in industries across the economy were privatized.[7] Privatizations begat the break-up of one-time Soviet firms into domestic Russian firms that now acted as foreign investors into privatized assets in other new countries. President Leonid Kuchma, in power in Ukraine from 1994 to 2005, presided over a government that brokered a number of notorious sales of state assets. Several of these involved Russian investors and went on to add fuel to the opposition in the Orange Revolution. Russian investors' special access to these gray sales speaks to the role of nationality in differentiating risks to contract sanctity – especially when one nationality is more likely to be entering into government contracts with lower levels of legitimacy.[8]

As Figure 5.2 demonstrates, however, it is not Russia but Cyprus that shows up as a sizeable source of Ukraine's FDI stock. In large part this can be attributed to diaspora investors from Russia who use Cyprus as a home for their firms, which accounts for Russia's otherwise small share of FDI in Ukraine. Russian individuals investing via Cypriot firms share historical and ethnic relationships with Ukraine unrelated to Cyprus. Nevertheless, Cyprus is a useful place for Russian investors to domicile their firms, because Cyprus is an EU member and it provides tax benefits. Cypriot investors share access to the Soviet-era Ukraine–Cyprus Double Taxation Treaty that is prominent enough for the Ukrainian Rada to regularly debate withdrawing from it. What is more, Cypriot nationality has benefits for Russian firms' contract sanctity. In particular, the Ukraine–Cyprus BIT has been the basis for several public international investment arbitrations (IAs) brought by Cypriot firms against Ukraine. For its part, the Ukrainian government understands that Cyprus is an attractive country from which to do business with Ukraine. Some ethnic Ukrainians also use Cypriot firms to invest back into Ukraine in a process known as "round-tripping." Suffice it to say here that Russian as well as Ukrainian individuals who domicile firms in Cyprus share risks to contract sanctity as a result of this choice, and these firms have taken advantage of Cypriot legal resources to fight breach. Even if the extent of these shared risks and resources is not as great as if firms had originated in the country of their CEO's birth, Cypriot firms' presence in Ukraine generates diversity in FDI just as any traditional national group would. By 2003, Cypriot investors were the second largest group in Ukraine after US investors. The peculiarities of applying the nationality shield theory to Cypriot investors are discussed below.

[7] This universality of privatization meant that firms of many nationalities bought into privatized assets. See Chapter 8 for a discussion of privatization as a source of potential variation to contract risks in its own right.

[8] Corruption has been a problem in privatization processes throughout the post-communist region. For an excellent treatment of the issue, see Schwartz (2006).

In short, a variety of OECD and some regional investors were responsible for Ukraine's increasing FDI national diversity through the early 2000s. In an interview, one Ukrainian politician summarized the growing diversity of investor nationalities in this period by pointing to South Korean firms' investment into auto parts manufacturing in the late 1990s. This event captured his feeling that Ukraine was truly integrating with the wider world economy, despite its status as a laggard in political and economic transition.[9]

Ukraine's FDI nationalities became less diverse beginning with a huge foreign investment into Ukraine: the October 2005 sale of Ukraine's major steel mill, Kryvorizhstal, to Mittal Steel for US$4.8 billion.[10] This FDI infusion, which took place under the democratizing Orange Revolution government, sparked the interest of other major Western European multinationals. Together with Russian investors, firms from a variety of Western European countries accounted for the subsequent FDI boom in consumer products, agriculture, and banking.[11] Ukraine's top ten FDI nationalities came to represent well over 75 percent of Ukraine's FDI stock by 2008 (compare Figures 5.2 and 5.3). This concentration decreased FDI national diversity even as Ukraine's FDI stock grew rapidly. US-origin investment now accounted for a relatively small proportion of Ukraine's FDI, thanks in part to a broken contract that is estimated to have cost Ukraine up to US$1 billion in US investment from 1998 to 2008.[12]

Figure 5.4 presents the average distribution of FDI stock by industry from 2000 to 2008.[13] We can be confident that the foreign firms at play in the Ukrainian economy were investing in quite a variety of industries, including finance, various forms of manufacturing, construction, and other uncategorized industries. Importantly, FDI is not accumulating predominately in those industries identified with the "obsolescing bargain," in which we would expect foreign firm leverage to be particularly constrained.[14] Indeed, manufacturing industries (with the exception of heavy industry in metals manufacturing) are thought to be some of the most mobile investments in the global economy. Furthermore, as summarized in Case Studies: Methodology, respondents informing each of the cases in this chapter come from a variety of industries, including industries involved in and not involved in prominent contract disputes and breach.

[9] Interview, Member of Rada, Ukraine, 2009.

[10] This sale as well as the role the complex national identity of Mittal Steel (soon ArcelorMittal) has played in its own contract disputes will be discussed in a subsequent section.

[11] WIIW Database on Foreign Direct Investment in Central, East, and Southeast Europe (2009).

[12] Davis, Jim, "Ukraine's Outstanding OPIC Debt: A barrier to foreign investment," *Business Ukraine Magazine*, 11 February 2008. Reprinted by the US–Ukraine Business Council.

[13] Unfortunately, data on distribution by home country and industry is unavailable.

[14] Vernon 1971.

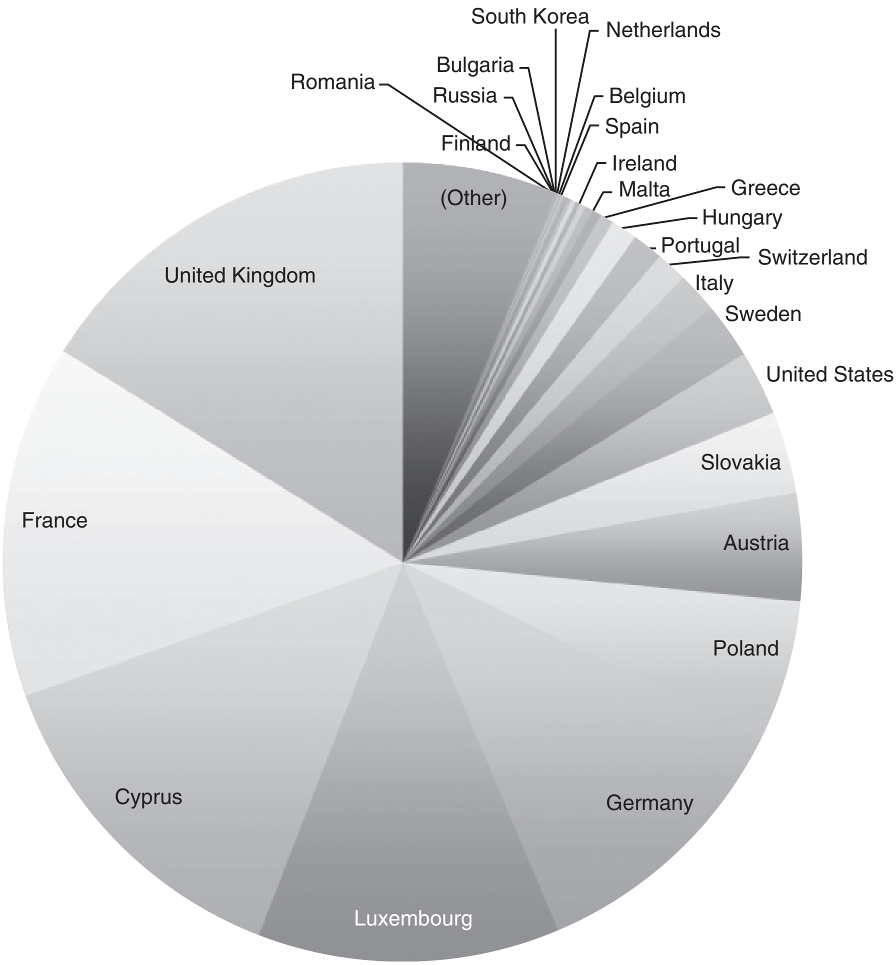

FIGURE 5.3 **FDI Nationality Distribution in Ukraine** (2008)
US$4.8 billion in FDI invested by ArcelorMittal is attributed to the four countries on which the subsidiary in Ukraine has claims: Germany, France, United Kingdom, and Luxembourg. See text for discussion.
Source: Vienna Institute for International Economic Studies (WIIW), Database on Foreign Direct Investment in Central, East, and Southeast Europe, 2009 Release.

FOREIGN FIRM PROTEST AND DIPLOMATIC ADVOCACY

By protesting to both home and host governments, foreign firms can make the consequences of government breach of contract more visible and immediately threatening to a host government's interests in maintaining capital access.[15]

[15] Hirschman 1970.

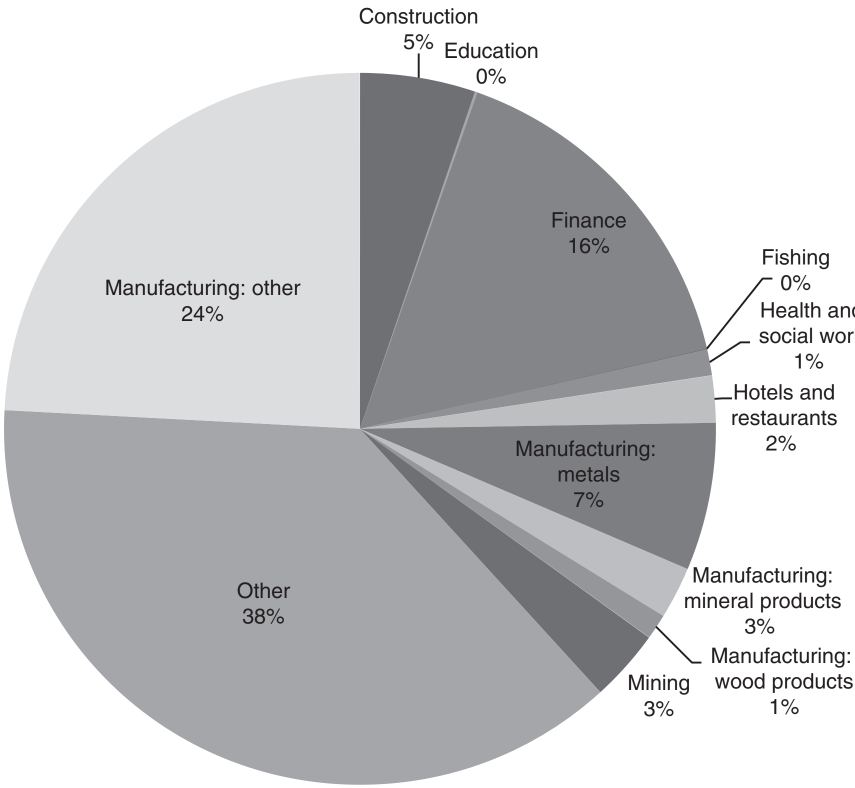

FIGURE 5.4 **FDI Stock in Ukraine by Industry (Average, 2000–2008)**
Source: Vienna Institute for International Economic Studies (WIIW), Database on Foreign Direct Investment in Central, East, and Southeast Europe, 2009 Release.

Co-national firms are aided in overcoming collective action problems and coming together to exercise protest, thanks to ties they share to institutions in both the home and host country. For example, foreign firms of the same nationality can coordinate their appeals to their home government through nationality-tied investor associations, which are often able to gain privileged access to host-government decision-makers. Host governments benefit from and often welcome the development of easy channels for communication with foreign firms. Moreover, diplomatic advocacy by the home country can tie the incidence of a breach to other issues in the bilateral relationship, adding foreign policy costs to the costs of capital loss, should the host government choose to breach. Protest can occur alongside or in lieu of intra-firm changes in investment strategies in response to breach, along the lines of the analyses in Chapter 4.

However, the likelihood that collective lobbying or diplomatic pressure will be successful in deterring breach depends in part on the broader set of foreign capital that can directly substitute or indirectly compensate for capital lost due to deteriorating relations with the targeted national group. In other words, when a country is host to a greater diversity of national investor groups, co-national actors have less leverage over the host government's capital access. This lowers the likelihood that co-national investors' own efforts, or efforts by diplomats on their behalf, will deter breach. As a result, co-national firms and home-country diplomats are expected to cut back their efforts when FDI national diversity is high. Scarce resources may be better spent on dealing with the fallout of breach. This implies that we should observe ineffective or limited lobbying and diplomatic efforts on behalf of contract sanctity in Ukraine from the late 1990s through 2004. In the following years, in contrast, diplomatic and lobbying activity should be strong and consequential. Regardless, these efforts should be consistently bilateral – and not multilateral – throughout both periods.

The following sections trace out prominent contract disputes, the presence or absence of protest by investors and diplomats, and ultimate breach or deterrence under conditions of both increasing and lower FDI national diversity in Ukraine. See Table 5.1 for summary findings.

AMERICANS AND AMMUNITION

US collective action failed to stop the Ukrainian government from breaking twelve firms' contracts from 1997 to 1999. The government subsequently violated its treaty commitment to the US Overseas Private Investment Corporation (OPIC), a US government agency that offers financing, investment funds, and political risk insurance for US investors in emerging economies. OPIC's investments are conditional on the host government's agreement to reimburse OPIC for political risk insurance claim pay-outs. The Ukrainian government failed for ten years to reimburse OPIC for a US$17.7 million claim. As a result, Ukraine is estimated to have lost up to US$1 billion in US investments that OPIC would have made, facilitated, or otherwise inspired.[16] The twelve contract breaches in the late 1990s and the non-payment to OPIC stand in contrast to conventional expectations that a government like Ukraine's is constrained to uphold its contracts with foreign firms in an era of economic globalization. Why these breaches occurred and why it took so long to resolve OPIC's breach have been considered puzzles even by the actors involved – especially as OPIC was consistently eager to resolve its dispute and re-enter Ukraine.

Unfortunately for US firms, other national groups of investors were uninterested in supporting US efforts concerning these breaches. US diplomatic pressure and co-national lobbying were ineffective for years. However, US firms and diplomats successfully came together on OPIC's behalf in the second half of the 2000s, in an environment in which Ukraine's FDI national diversity had

[16] Davis, Jim, "Ukraine's Outstanding OPIC Debt: A barrier to foreign investment," *Business Ukraine Magazine*, 11 February 2008. Reprinted by the US–Ukraine Business Council.

TABLE 5.1 *Summary, Major Contract Disputes in Ukraine*

FDI National Diversity	Year	Case	Nationality	Diplomacy	Co-national lobbying	Outcome	As predicted?
High	1997–1999	Twelve firms	US	Weak	Weak	Breach	Yes
	2004	OPIC	US	None	None	Breach	Yes
	Early 2005	Kryvorizhstal	Cypriot	None	None	Breach	Yes
Declining	2005	Reprivatization	(All)	Strong	Strong	Deterrence	Yes
	2005	Reprivatization	Russian	Strong	Strong	Breach/ Settled	No/Yes
Low	2005–2009	OPIC	US	Strong	Strong	Settled	Yes
	2005–2009	Telenor	Norwegian	Strong	Strong	Deterrence	Yes
	2007–2009	ArcelorMittal: VAT	Multiple	Strong	Strong	Breach/ Settled	No/Yes
	2006–2010	ArcelorMittal: Regulatory	Multiple	Strong	None	Deterrence	Yes

fallen and then plateaued. The Ukrainian government proved willing to follow through with restitution to OPIC after a ten-year delay.

American Bluffs

In 1997, the US government had major foreign policy interests in securing nuclear materials in Ukraine, establishing Ukraine's relationship with NATO, and gaining a foothold in Ukraine in part because of Ukraine's position vis-à-vis Russia. Despite these pressing "high politics" bilateral issues, the US Congress tied the distribution of foreign aid to Ukraine directly to the outcome of the government's contract disputes with twelve private US investors – an action unprecedented in Ukraine or elsewhere in the post-communist region. Congress threatened to withhold up to 50 percent of discretionary aid promised to Ukraine, amounting to about US$80 million, if the Ukrainian government did not ensure that "United States investors who have been subjected to . . . inappropriate, corrupt activities carried out by officials or representatives of the Ukrainian government are provided with full restitution or compensation for their losses."[17] The legislation referred to the list of twelve firms assembled by the US Embassy in Ukraine, which included major US multinationals like Cargill as well as smaller investors. Conditional US aid was clearly distinguished from unconditional aid intended to reinforce Ukraine's nuclear security, promote democracy, or restructure markets. Nevertheless, the US Secretary of State was to report to Congress on whether sufficient progress had been made to merit aid distribution, and the US Embassy in Ukraine was to confirm restitution in a series of regular follow-up meetings with the Ukrainian government.[18]

With the approval of the State Department, Congress distributed Ukraine's aid in full in 1998 – despite the protests of US firms and investor associations in Ukraine. From the point of view of US firms, the Kuchma government had taken no action on these twelve firms' broken contracts and had not assuaged US concerns about their broader contract sanctity. Congress followed up with a similar threat to withhold aid from Ukraine in legislation in 1998: the United States would not distribute the aid allocated to Ukraine in the 1999 budget if Ukraine did not make "continued progress on resolution of complaints by American investors."[19] The Kuchma government called the US bluff and again did nothing. This time, US firms in Ukraine accused the US ambassador to Ukraine of "fudging the numbers" to overstate progress toward resolution, and Ukraine received its aid in full.[20] The mandated meetings between the

17 Congressional Record – House. Page H3698. Sec. 1717. Sense of Congress Concerning Assistance for Ukraine. Subsection (5). Amendment offered by Mr. Fox of Pennsylvania. June 11, 1997.

18 Interviews (3), Washington, D.C., 2012.

19 Congressional Record – Senate. S9999. Assistance for the New Independent States of the Former Soviet Union. September 8, 1998.

20 "Pifer fudges the numbers," *Kyiv Post*, 25 February 1999.

US Embassy and the Ukrainian government to follow up on restitution never occurred.[21] In 1999, an US official lamented the "international brouhaha" over the broken contracts.[22] Why did diplomatic efforts crumble and fail to push the Kuchma government to restore US firms' contracts?

The diversity of foreign investor nationalities in Ukraine had increased in the years leading up to 1997, and 1997 to 1999 brought significant new entry of OECD-origin investors into the country (see again Figure 5.1). Ukraine, which has been a transition laggard compared to its western neighbors, was just becoming an attractive investment destination with healthier macroeconomic fundamentals including economic growth and better control over inflation. US investors were early entrants into Ukraine, but large Western European countries grew their investments quickly. Western European FDI gained a good reputation in Ukraine for promoting local development and economic growth. Economic integration with Western Europe also supported Ukraine's hopes to "return to Europe" now that its Soviet identity was gone.[23] Against this backdrop, the potential loss of US$80 million in US aid and the further exit and deterrence of US-origin FDI posed less of a threat to Ukraine's capital access and international standing than it might have otherwise.

European-origin investors and their home governments had strong incentives to stay removed from US disputes. Far from facing risks to contract sanctity in Ukraine, Western European firms received privileges. In its efforts to become "European," Ukraine was particularly keen to build strong relationships with Western European home countries. This speaks to geopolitics as a source of variation in US versus other firms' contract sanctity. Indeed, US investors were frustrated by what they saw as discrimination. In testimony before Congress in 2000, the head of an US investor organization in Ukraine expressed his low expectations for collaboration between European and US investors:

> It is common practice for these [post-communist] governments to be told by the Europeans, in some cases rather bluntly and in others rather delicately, that you had better remember which side your bread is buttered on when it comes to letting these contracts. Certainly I have run into this in the Ukraine, where Ukraine, which aspires to be an EU member, has been told in various ways in various cases that ... contracts better go to German or French companies, not American companies.[24]

This well-placed US executive saw that, far from worrying that the political problems of US firms were harbingers of their own future, European-origin firms benefitted from their own convivial government relations. There was fierce competition for investment between US and German and French firms.

[21] Interview, Washington, D.C., 2012.

[22] "US Presses Investor Disputes," *Kyiv Post*, 11 February 1999.

[23] Wilson 2005.

[24] Congressional Record – Senate. "Treatment of US Business in Eastern and Central Europe," Hearing before the Subcommittee on European Affairs of the Committee on Foreign Relations. 106th Congress, Second session, 28 June 2000.

European firms had little incentive to risk their privileges by getting involved in US firms' disputes. Indeed, at this time Western European firms likely faced less vulnerability when it came to contract sanctity.[25]

Investors from transition countries were also relatively indifferent to Americans' contract sanctity, as US disputes were not relevant enough to their own contract risks to merit coordination with US efforts.[26] The context in which transition country firms' contracts were formed resulted in different risks to contract sanctity. The Soviet economy had been characterized by soft budget constraints, meaning that bureaucrats' commitments to cut off funding to loss-making enterprises were not credible.[27] With the fall of the Soviet Union, some of the debts incurred thanks to soft budget constraints were now spread between different countries' state-owned enterprises. As privatization proceeded, both private and state actors became involved in negotiating inter-enterprise foreign debt settlements. In Ukraine, this meant that newly minted foreign investors from Russia and other countries in the region had to work out legacy debts together with their newly minted home governments and the newly sovereign Ukraine. Regional firms and governments were willing to write off the Ukrainian government's non-payment of an outstanding debt for a write-off of their firms' legacy debts. For them, this was a mutually intelligible and legitimate transaction.[28] Further, regional firms making greenfield investments in Ukraine shared a common Soviet legacy that allowed contracts to be tacit and flexible when compared with US investors' more arms-length, formal agreements. Without the historical interdependencies or flexible contracting that shaped regional investors' relations with the Ukrainian government, a US firm was constrained to see government non-payment as a breach of contract.

Moreover, firms from post-communist countries have been exposed to different contract risks as each of their newly separate governments worked out bilateral relations with Ukraine. These bilateral contract risks have been mediated by shared and sometimes conflicting cultural histories. Ukraine's bilateral relations in the region have also been shaped by the geographical distribution of assets like oil and gas pipelines that, with the fall of the Soviet Union, became sources of conflicts with Russia, Belarus, and other previous Soviet trading partners now separated by rigid national borders. With different kinds of contracts, different means of resolving disputes, and different political considerations, actors from regional countries did not support US efforts. Nor, we will see, did the United States support regional firms that did in fact face broken contracts.

For their part, US firms pressed the US Embassy for support in restoring contract sanctity. Two US investor associations, the American Chamber of

[25] Cases in which Western European firms' contract sanctity varies are discussed in subsequent sections and in Chapter 6.
[26] Interviews (3), Russian finance and manufacturing firms, Ukraine, 2009 and 2011.
[27] For an excellent treatment of this problem, see Kornai (1992).
[28] For helpful models of how transition countries resolved these problems, see Roland (2004).

Commerce (ACC) and the US-Ukraine Business Council (USUBC), lobbied Ukrainian officials as well as US officials on behalf of their memberships. In 1997, a US Congressman said that he knew that "25 percent of all ... the Embassy [in Ukraine] does is expedite American business problems."[29] Both the ACC and the USUBC strongly objected to the full distribution of aid after the 1997 threat. Local actors saw the repetition of the same ultimatum in 1998 as an empty threat.[30] Nevertheless, the ACC withdrew its objection to the full distribution of aid this second time around. The ACC's leadership had changed from 1998 to 1999, and its new managing director took the stance that, "in the long term, [the distribution of aid] will result in a more favorable investment environment."[31] The ACC offered no more public statements on the twelve US firms' contract disputes. Since 1999, in fact, the ACC has changed its policy and refuses to get involved in contract disputes between particular firms and the Ukrainian government, wanting instead to be a broad-based lobbying organization focused on investment policy.[32] Efforts to restore US firms' contract sanctity died out.

In 1999, the Ukrainian prime minister publicly placed fault for the firms' broken contracts on the side of naïve Americans who had gotten involved with "God knows whom."[33] In a strange twist, Ukraine's gray economy became useful political cover for the government's inaction in repairing broken contracts. Notably, this framing went unchallenged by Americans. At least one of the twelve firms went on to sue Ukraine under the US–Ukraine BIT; another decided to pursue its case in Ukrainian courts; a third made repeated, unsuccessful attempts to regain the US State Department's interest; and a fourth became the ten-year breach of contract with OPIC.

OPIC's Broken Contract

Alliant Kyiv, formed in 1992, was a joint venture to recycle 220,000 tons of government-owned ammunition. The Ukrainian government owned 41 percent of the firm; its main contribution was to deliver the ammunition and grant Alliant Kyiv the rights to sell recycled materials on world markets. The US multinational Alliant Techsystems owned a 39 percent stake and, by 1998, had invested US$22 million and trained local personnel to use a safer recycling

[29] Congressional Record – House, H3674, Comment by Mr. Hastings of Florida. June 11, 1997. He went on to say, "We cannot have people, either in tourism or in business, all over the world and not have our facilities to help them."

[30] Interviews (4), US investor associations, Ukraine and Washington, D.C., 2011. For the terms of the 1998 ultimatum, see Congressional Record – Senate. S9999. Assistance for the New Independent States of the Former Soviet Union (b). September 8, 1998.

[31] "Pifer Fudges the Numbers," *Kyiv Post*, 25 February 1999.

[32] Interview, American Chamber of Commerce, Ukraine, 2009.

[33] "US Presses Investor Disputes," *Kyiv Post*, 11 February 1999.

process than the Soviet standard.[34] Alliant Techsystems bought political and expropriation risk insurance from OPIC to protect its investment. The joint venture became quite successful, making millions selling recovered gunpowder, industrial explosives, and, most importantly, scrap brass.

In the first ten months of 1998, Alliant Kyiv exported 1,640 tons of brass for US$2.13 million.[35] This was less than two-thirds of the volume of brass the Ukrainian Defense Ministry was obligated to deliver to the joint venture. Local observers speculate that the unexpected profits to be made in recycled materials tempted the Defense Ministry to process the materials itself, using the more dangerous but cheaper Soviet method. There were reports that the Kuchma administration opposed the Defense Ministry's decision to break the contract, but Kuchma, likely wary of internal divisions in advance of the 1999 presidential elections, did not publicly address the Defense Ministry's disobedience.[36] Alliant Techsystems, the US Embassy, OPIC, the Defense Ministry, and the Kuchma administration negotiated, but to no avail. In a colorful retelling, one US advocate recalled the Deputy Minister of Defense saying, "OPIC shafted us once – they'll shaft us again."[37] In 1999, Alliant Techsystems ended its investment in Ukraine and received US$17.7 million in compensation from its political and expropriation risk insurer, OPIC.

Unlike private market insurance providers, OPIC's participation in an emerging economy is contingent on the host government's agreement to reimburse it for any political risk insurance claim it pays out. Those involved with Alliant Kyiv's case at OPIC thought the reimbursement would not be a problem: US$17.7 million was a relatively small sum, OPIC had already facilitated over US$200 million in investments in Ukraine and stood ready to do more, and its threat of exit was credible.[38] OPIC was also willing to negotiate over the terms of repayment and the public reasons for which that payment was made, as OPIC did not require Ukraine to admit guilt in the matter.[39] But Ukraine did not pay, and OPIC exited in 1999. In 2000, US investors gave Congressional testimony on their treatment in Ukraine, but OPIC's broken contract was not mentioned.[40] After the previous failure of diplomatic

[34] A British firm (Rapierbase) and a Ukrainian firm (EKOP) each owned 10 percent; they acted as "liaisons" for either side. "Rift threatens to blow up ammunitions joint venture," *Kyiv Post*, 30 October 1998.

[35] "US Presses Investor Disputes," *Kyiv Post*, 11 February 1999.

[36] Ibid.

[37] Interview, Washington, D.C., 2012.

[38] Interview, OPIC, Cambridge, MA, 2009.

[39] From OPIC's point of view, claims and reimbursements are intended to be "no fault." The payment means only that the host government participated in such a way that the firm lost money. Interviews (2), Washington, D.C., 2012.

[40] Congressional Record – Senate. "Treatment of US Business in Eastern and Central Europe," Hearing before the Subcommittee on European Affairs of the Committee on Foreign Relations, 106th Congress, Second session. 28 June 2000.

advocacy, OPIC's broken contract received little attention from the US government or other US investors.

OPIC continued to negotiate with the Ukrainian government, reaching a provisional settlement in 2004. The settlement turned out to be cheap talk. The Kuchma government agreed that OPIC would reopen operations in March 2004, conditional on the government repaying its debt by January 2005. But the Kuchma regime would be replaced in January 2005, either by Kuchma's preferred successor, Viktor Yanukovych, or the Orange presidential candidate, Viktor Yushchenko. The Orange Revolution, from November 2004 to January 2005, overthrew the Kuchma regime and replaced it with the pro-reform, pro-Western, democratic Orange coalition. This marked a major moment of turmoil in Ukraine's domestic priorities, bureaucracy, and legal institutions.[41] Fulfilling a settlement with OPIC may have understandably fallen by the wayside, and an understanding OPIC official recognized that "reinstatement is not a priority during elections."[42] However, the Orange government never took action on the settlement, and OPIC again exited in late 2005.

The Orange government's public rationale for not providing restitution to OPIC was analogous to that offered by the Kuchma government in a 1998 letter: "payment of compensation to OPIC on an expropriation lawsuit in Ukraine may negatively affect foreign firms' opinion about the investment climate in Ukraine."[43] Put differently, the government thought that inaction over OPIC had limited repercussions, so long as expropriation was only OPIC's and other Americans' interpretation of events surrounding Alliant Kyiv. US-origin FDI might be deterred, but the Ukrainian government did not expect other foreign firms to receive an equivalent negative signal.

Collective Action and Restitution

In October 2005, Mittal Steel invested US$4.8 billion in Ukraine.[44] This investment, combined with new Western European investments in a variety of industries, left FDI less equally distributed across national groups, which reduced the effective number of national groups on which the Ukrainian government could rely for current and future FDI (see again Figure 5.3). OPIC's long absence meant that fewer small and medium-sized US enterprises had been investing in Ukraine; by 2008, US-origin FDI had fallen to seventh place among OECD countries. Although US investors held a smaller share of the government's access to FDI, they now operated in an environment in which breach with any one national group carried higher costs for the Ukrainian government's future access

41 Beissinger 2013.

42 Interview, OPIC, Cambridge, MA, 2009.

43 "Rift threatens to blow up ammunitions joint venture," *Kyiv Post*, 30 October 1998.

44 See subsequent sections for a discussion of this sale and Mittal Steel's role in shaping Ukraine's FDI national diversity.

to capital. These circumstances enabled US firms to come together to lobby the US government to take up OPIC's cause and to put direct pressure on the Ukrainian government to provide restitution and facilitate OPIC's re-entry.

The US–Ukraine Business Council (USUBC) became the vehicle through which US firms lobbied the US and Ukrainian governments. Founded in 1995, the USUBC was first intended to be a close-knit club of large US firms investing in Ukraine, though the original members were mostly clients of the president's public relations agency.[45] The USUBC flexed its lobbying muscles during the failed 1997 to 1999 efforts on behalf of the twelve US firms with broken contracts, but it was mainly a networking and social forum at that stage. After the lobbying failure in 1999, dues-paying members in the USUBC fell from twenty-two to eight. In 2007, Sigma Bleyzer, a large private equity investor in Ukraine and elsewhere in the post-communist region, started rebuilding the USUBC as an association capable of promoting American business interests in Ukraine. With Sigma Bleyzer's financial and organizational support, the USUBC grew to 150 members by 2011, including small and large US multinationals from a wide variety of industries.[46] The USUBC membership also grew to include US firms that were interested in but had not yet entered the Ukrainian market, giving the USUBC the ability to represent deterred US investors as it lobbied the Ukrainian government. New USUBC members understand that they join an American-centric association that takes positions on particular firms' conflicts with the government, and members sometimes contribute extra funds in support of particular campaigns.[47]

The USUBC was made more important because the other American investor association in Ukraine no longer identified itself with American investors. The American Chamber of Commerce in Ukraine had rebranded itself as "the Chamber" (hereafter Chamber/ACC), becoming a broad-based group with members from a variety of national origins. The Chamber/ACC now focused its lobbying efforts on the Ukrainian government and did not actively seek US government support. It advocated on issues around which the foreign business community was in relative consensus, which excludes particular instances of government breach of contract. The Chamber/ACC leadership perceived that lobbying on behalf of particular firms of any nationality would threaten the credibility it has built with the Ukrainian government as "the voice of foreign business in Ukraine."[48] With this change to the Chamber/ACC, the USUBC was

[45] Interview, USUBC, Ukraine, 2009.

[46] Microsoft was eager to join as the USUBC's 100th member. The Ukrainian president attended a gala event celebrating its membership. Interview, USUBC, Ukraine, 2009.

[47] As one example of its US focus, the USUBC conducts all of its business in English so as to avoid the complications translation can cause. The USUBC does not talk to the Ukrainian media for this reason. Its meetings are always off the record. Interviews (3), USUBC, Washington, D.C. and Ukraine, 2009 and 2012.

[48] Interview, American Chamber of Commerce, Ukraine, 2009.

left as the only investor association positioned to aggregate US interests around contract breach.

The USUBC took up OPIC as a cause in 2005. Some USUBC members expected to benefit directly from renewed access to OPIC financing or subsidized insurance.[49] But many of the USUBC's members had little to directly gain from OPIC's reinstatement. The USUBC's largest members, including firms like Procter and Gamble, IBM, KPMG, and Halliburton, have other, cheaper sources of internal or external financing for projects compared to what OPIC can provide. Large firms are also often priced out of political risk insurance markets, or they use mechanisms like diversification and currency hedging to take account of politically derived risks.[50] Executives at such firms claim to have participated in the USUBC efforts in hopes of renewing Ukrainian commitments to US investors.[51] On the diplomatic side, the US ambassador to Ukraine attributed his strong and vocal support for OPIC to USUBC efforts.[52] The Ukrainian vice prime minister, who ultimately shepherded OPIC reinstatement through his government, threw his support behind OPIC after a USUBC meeting, in which the US ambassador as well as firms like Microsoft, Baker & McKenzie, Cargill, and DHL took part.[53] Unlike the 1997 to 1999 efforts that quickly fizzled, the USUBC brought US firms, diplomats, and key Ukrainian politicians on board for a long campaign. The USUBC's leadership and representatives of its member firms became regular interlocutors with the US ambassador and the Ukrainian president and Council of Ministers, discussing OPIC with them in at least forty meetings from 2005 to 2009.[54]

Working together, US actors made the issue of an old broken contract salient to a Ukrainian government that was responsible for neither the original 1998 breach nor the breach of the provisional settlement in 2005. US actors' main task

[49] In his advocacy efforts, USUBC President Morgan Williams repeatedly cited OPIC's estimation that they had US$500 million of investment committed to enter Ukraine upon reopening. USUBC workshops on OPIC financing held in early 2010 attracted 260 representatives from US firms. As reported by the USUBC.

[50] The Ukrainian country leader at a major oil firm, who requested a copy of my interview questions in advance, was puzzled by the mention of political risk insurance. Before the interview, he asked around the office and called headquarters to see if the firm used it. He reported that he could only find one instance: an export credit agency might have supported the firm's investment in a several billion dollar pipeline in China. Interview, foreign firm in oil and gas, Ukraine.

[51] Interviews (3), US firms, Washington, D.C. and Ukraine, 2009 and 2011.

[52] The ambassador was disappointed that OPIC was not fully reinstated before his term ended in mid-2009. Interview, USUBC, Washington, D.C., 2012.

[53] Firms with investment interests in the United States can also join the USUBC; these members, too, stand behind campaigns on behalf of particular US firms. Interviews (3), Washington, D.C. and Ukraine, 2009 and 2011. "Hryhoriy Nemyrya met with American investors," Press office of Vice Prime Minister of Ukraine, 31 January 2008. Reprinted by USUBC.

[54] Compiled from USUBC records. In 2008, USUBC President Williams stated that the OPIC dispute was under discussion in every meeting he had attended, in Washington or Kyiv, in recent years. Morgan Williams, "OPIC programs closed for Ukraine," US-Ukrainian Business Council News Release, 13 February 2008.

was to assuage the Ukrainian government's concerns that OPIC restitution would have a negative effect on non-US foreign investment. The two governments signed a Memorandum of Understanding in 2008 addressing this point, resolving that the breach "should not be considered as constituting any admission on behalf of the Ukrainian side of any commitment, debt, complaint, or other claim of any company."[55] In 2009, US Vice President Biden lauded this progress during a visit to Ukraine, saying that bringing OPIC back would "make it easier for American companies to reinvest in Ukraine, and invest in the first place."[56] Two days before the final Council of Minister's meeting to approve the restitution settlement in 2009, OPIC's champion in the Ukrainian government took the unprecedented step of inviting the USUBC president to help draft the final resolution in order to avoid more bureaucratic hold-ups. Once signed, OPIC immediately restored operations.[57]

OPIC's reinstatement took place thanks to the growth of the USUBC and its sustained efforts to organize US lobbying and diplomatic efforts. Interestingly, OPIC played only a small role in the multi-year campaign for its own reinstatement.[58] It was the USUBC that pulled in the support of US diplomats and key Ukrainian officials, taking advantage of its membership's interest in what OPIC's re-entry meant for the treatment of US investors more broadly. The late 2000s brought an environment in which fewer other national groups were available to substitute for foregone US-origin FDI – despite the fact that Ukraine hosted FDI at unprecedentedly high levels (even as the worldwide financial crisis began). Faced with concurrent strong US diplomatic and investor pressure for restitution, the Ukrainian government restored contract sanctity for US firms.

Considering Alternative Explanations

When pushed for an explanation, US actors attribute the decade-long OPIC breach to inter-agency confusion within the Ukrainian government and its bureaucracy.[59] When the Ukrainian government violates a contract with a foreign firm, that firm interacts with low-level bureaucrats in the customs, tax, or other relevant administration, perhaps writing letters to gain a meeting with higher-level Ministry officials. Disputes remain housed within particular

55 "Bogdan Danylyshyn and William Taylor sign Memorandum," Ukrainian Ministry of Economy, Minister's Press office, 11 November 2008.

56 Statement by Vice President Biden after meeting with President Viktor Yushchenko of Ukraine. The White House, Office of the Vice President, 21 July 2009.

57 Consistent with OPIC's position all along, the settlement did not require a direct payment of US$17.7 million. The agreed-upon US$5 million payment was off-budget, to be paid in two payments per year over ten years. The funds were to come from a commercial group recycling leftover ammunition from Alliant Kyiv. This settlement further demonstrates OPIC's willingness to compromise in order to re-enter Ukraine.

58 Interviews (4), OPIC and USUBC, Washington, D.C., 2009 and 2012.

59 Interview, OPIC, Cambridge, MA, 2009.

administrations, as there is no state structure with the overall mandate to interact with foreign firms.[60] Lawsuits are handled within the Ministry of Justice; only if a legal dispute becomes an IA does the Ministry of Justice call a meeting with the cabinet of ministers, prime minister, and president.[61] Foreign firms in Ukraine are conscious of these institutional disconnects between government lawyers, low-level bureaucrats, and politicians at the highest levels. This is one reason that the USUBC's ability to cultivate relationships with top Ukrainian politicians was important to OPIC's resolution. By aggregating US firms' protests, the USUBC gained the clout to bypass the bureaucratic apparatus and access politicians who can be difficult for even the most prominent of foreign firms to reach.

Yet bureaucratic confusion is an implausible explanation for the progression of US efforts. If it was only red tape that kept the Ukrainian government from realizing its genuine interest in resolving US disputes, it is unlikely that US actors would have given up their advocacy so quickly in the late 1990s and for so many years. Ukraine's successive presidents and prime ministers were in fact aware of the OPIC issue and gave lip service to its importance over the breach's ten-year duration. Rather than attributing inaction to the issue being lost in Ukraine's bureaucracy, the explanation offered here takes seriously the Ukrainian government's worries that restitution would be consummate to signaling to all foreign investors the state's willingness to expropriate. It also takes seriously the variation in US diplomats' and firms' willingness to support the cause. As by 2009 the complexity of Ukraine's bureaucratic institutions dealing with foreign investors had not changed, renewed US interest in the cause more plausibly contributed to Ukraine's actions.

Industry-based collective action played no role in bringing about OPIC's restitution. We might expect that the political risk insurance and project finance industry in Ukraine would be interested in fighting the OPIC breach, for fear of the precedent it would set for their own interactions with the government. In Ukraine, members of this industry include OPIC-like agencies from other home countries as well as public, multilateral organizations including the Multilateral Investment Guarantee Agency (MIGA), the International Finance Corporation (IFC), and the European Bank for Reconstruction and Development (EBRD). However, public funding does not keep these organizations from considering themselves OPIC's competitors. Rather than signaling shared risks, OPIC's contract breach opened up a new set of potential US clients seeking political risk insurance and financing that now did not have the option of using an

[60] At least four official agencies tasked with interacting with foreign firms have existed in Ukraine. Individuals in the foreign investment community, as well as at multilateral organizations, view these agencies as irrelevant. Interviews (2), including current Ukrainian agency tasked with foreign investor relations, Ukraine, 2009.

[61] Interviews (2), foreign and domestic law firms representing both the Ukrainian government and foreign firms in international litigation, Ukraine, 2009 and 2011.

US institution.[62] Respondents at various organizations acknowledged the competitive advantage they gained from what they framed as OPIC's "mistake": "OPIC really shouldn't have financed a business on a military base."[63] Given that other players gained competitive advantages as a result of OPIC's absence, and they did not see themselves engaging in analogous contracts, industry-based support for OPIC did not substitute for nor complement US actors' efforts.

NORWEGIANS, RUSSIANS, AND CELL PHONES

From 2005 to 2009, the state-owned Norwegian telecommunications firm Telenor was embroiled in a commercial dispute that spilled over into its relations with the Ukrainian government. The government faced significant pressure to breach its commitments to Telenor, not only from domestic sources but also from Russian business and political actors aiming to gain by Telenor's downfall. But with fewer other national investor groups to draw on in this period, the Ukrainian government was sensitive to retaining Norwegian investment. In fact, preserving Norwegian investment in Ukraine was necessary to keep the mobile telecommunications industry from being wholly Russian-owned, an outcome opposed by virtually all political players in Ukraine.

The nationality shield theory predicts that co-national action among Norwegians in Ukraine should have been strong in this environment of low FDI diversity. Other private Norwegian firms should have acted as though their contract sanctity were tied up with Telenor's. What is more, as a state-owned firm, Telenor likely had ready access to diplomatic resources. Indeed, while the Ukrainian government at times wavered in its treatment of Telenor, it ultimately did not break its commitment to the firm's fundamental ability to operate and own property in the country. The preservation of Telenor's contract in Ukraine stands in clear contrast to Telenor's experience in Russia, where the Russian government expropriated Telenor in the context of high FDI national diversity. In that country, Norwegian lobbying and diplomatic pressures were weak. This difference between the Ukrainian and Russian experiences corresponds to the idea that actors have less incentive to fight contract breach when FDI national diversity is high and the likelihood of successful deterrence is low – even if the state owns the firm in question.

Telenor was the majority owner of Kyivstar, Ukraine's leading mobile service provider, and it invested US$1.3 billion in Ukraine from 1997 to 2010. Telenor's conflicts grew out of its contentious relationship with Alfa Group, a Russian oligarch-owned conglomerate. By 2005, Telenor and Alfa Group's partnerships were complex: Telenor was the majority owner of Kyivstar (57 percent) and Alfa

[62] It is hard to draw conclusions about the effects OPIC's absence might have had on pricing in the industry, as the terms of deals tend to be entirely project-based. Interview, European Bank for Reconstruction and Development, Ukraine, 2009.

[63] Interview, international organization, Ukraine, 2009.

Group was the minority owner (44 percent); in Russia, their positions were switched as Alfa Group was the majority owner of VimpelCom (44 percent) and Telenor was the minority owner (30 percent).[64] The core of the commercial dispute between Telenor and Alfa Group was over the interpretation of the shareholders' agreements in each of these ventures. The Kyivstar agreement prevented either party from taking more than a 5 percent stake in a competing mobile provider, and the VimpelCom agreement required the board to approve any acquisition. The crux of the matter was that Russia's Alfa Group, both directly and via VimpelCom, invested significantly in two Kyivstar competitors without Telenor's approval.[65]

The Conflict in Russia

The VimpelCom conflict was specific to Russia, where Alfa Group is the domestic firm and Telenor is the foreign firm. Looking back at Figure 5.1, we see that Russia's FDI national diversity in the late 2000s has been higher than Ukraine's. As a large economy with a significant endowment of natural resources, Russia possesses the structural features expected to give its government leverage over foreign firms at the time of investment and after contracts have been struck.[66] High levels of FDI national diversity are consistent with this expectation of power on the side of the Russian government. Throughout the 2000s, Russia's political actors proved very willing to engage in high-profile conflicts with foreign firms, and there is strong evidence that the legal system was manipulated to the detriment of foreign firms' property rights.

The Norwegian government had previously intervened in Russia on Telenor's behalf in 2000 and 2004, first to deter the Russian Communications Ministry from taking back allocated frequencies, and second to lower Telenor's suddenly high tax burden.[67] In the second half of the 2000s, however, Telenor lost several legal cases that were brought by shadowy shareholders and heard in obscure Siberian towns in what were seen by international observers as politically driven rulings. Once these decisions began coming down against Telenor, Norway's government stepped back. In 2006, the Norwegian Trade and Industry Minister

[64] For the ease of the reader, I use the parent firm, Alfa Group, to stand in for the various wholly owned subsidiaries that were involved in transactions with and litigation against Telenor. These include Storm LLC, Altimo, Eco Telecom, Alfa Telecom, and Alpren.

[65] VimpelCom's board of directors had three members that are independent, three appointed by Telenor, and three appointed by Alfa Group. According to the shareholders' agreement, purchasing shares in other companies required an 80 percent majority of shareholder votes. Without Telenor's votes, VimpelCom did not have sufficient approval for its actions. "Russia's VimpelCom signs option to buy Ukraine's WellCom," Prime-Tass English language business newswire, 18 March 2005.

[66] E.g., Vernon 1971.

[67] "Norwegian Telenor offered ultimatum to VimpelCom," *Russian Business Monitor*, 1 April 2005. (Original source: *Vedomosti*, 30 March 2005.)

said his government would not interfere and that "there should be no concern that the conflict between Telenor and Alfa would scare away Norwegian investment in Russia."[68] With this statement, the Norwegian government explicitly attempted to downplay the bilateral implications of Russian actions against Telenor.

Similarly questionable legal procedures had resulted in broken contracts in Russia before, but foreign firms of other national origins with analogous experiences did not come to Telenor's aid. The British oil and gas firm BP had faced questionable court decisions that resulted in the effective expropriation of its stake in the joint venture TNK-BP, but BP made no public comment on Telenor's situation.[69] Neither did the Swedish-Finnish telecommunications firm TeliaSonera, which too had faced a shareholder dispute involving Alfa Group.[70] Why did these firms keep quiet? I contend that whatever solidarity they might have felt with Telenor was outweighed by these firms' sense that their contract sanctity was not tied up with the outcome of Telenor's contract dispute. Perhaps Telenor's problems helped them avoid further conflicts with the Russian government or gained them competitive advantages. Regardless, firms across different nationalities – even those having faced the same problems – remained publicly indifferent.

In an environment in which entry and reinvestment by a variety of national groups was the norm, and in which the Telenor dispute gained no supporters even from other firms facing similar problems, the Norwegian government explicitly stepped back from using its nationals' FDI in Russia as leverage in the Telenor conflict. The Russian government had little incentive to change its stance toward Telenor's operations and followed through with expropriation. By 2010, Telenor's accrued fines totaled US$1.7 billion. The Russian government froze Telenor's assets, effectively halting its ability to operate in Russia.

"The War against Telenor in Ukraine"

Telenor and Alfa Group's conflict in Ukraine began in earnest in 2005. Against Telenor's wishes, the two firms' Russian joint venture purchased a direct competitor to Kyivstar, their Ukrainian joint venture. Having benefitted from the Russian government's breach of contract with Telenor in Russia, Alfa Group continued "the war against Telenor in Ukraine," in the words of a major Russian newspaper.[71] Alfa Group's first Ukrainian lawsuit challenged the legality of Kyivstar's shareholders' agreement, though the agreement had

[68] "Norway, Russia don't plan to interfere in Telenor, Alfa Conflict," *Ukraine Business Daily*, 16 March 2006.

[69] Gustafson 2012.

[70] TeliaSonera had a 44 percent stake in a Russian mobile firm (Megafon) and had been involved in its own shareholder dispute with Alfa Group, owner of a 25 percent stake.

[71] "Alfa Group continues the war against Telenor in Ukraine," *Russian Business Monitor*, 22 April 2005. (Original source: *Vedomosti*, 20 April 2005.)

been negotiated just one year prior. A Ukrainian court found in favor of Telenor and upheld the shareholders' agreement, and the Ukrainian government publicly supported the verdict.[72] In this case, the Ukrainian legal system and government maintained commitments to contract sanctity. This outcome is especially important, because the government's actions aligned with the international norm of government non-interference in private, voluntary agreements, and the government also followed the Commercial Code of Ukraine's explicit prohibition of "unlawful intrusion by governmental authorities and their officers in economic relations."

However, Alfa Group shortly began winning court cases in Ukraine, restricting the authority of Kyivstar's board of directors (August 2005), banning a board of directors meeting (December 2005), and requiring that Telenor and Alfa Group should have equal representation on the board despite Telenor's owning 13 percent more shares (January 2006). The Ukrainian Supreme Economic Court upheld this last ruling (February 2006).[73] In 2007, a court ruling forbade Ernst & Young from auditing Kyivstar without board approval, which was impossible to get as Alfa Group had been boycotting Kyivstar's board meetings for nearly two years. Not only the verdicts in these cases but also their existence were contrary to the shareholders' agreement, which stated that all conflicts would be resolved in international courts and would not be prosecuted under Ukrainian law. By hearing these cases, the judicial system was complicit in a violation of the shareholders' agreement. When an international judge was finally able to rule on a case brought by Telenor, he called Alfa Group's Ukrainian lawsuits "collusive and vexatious litigation" and wrote that Ukrainian legal opinions "appear to be nothing more than a sham."[74] The Ukrainian courts did not respond immediately or in full to this or subsequent international rulings requiring them to stop hearing cases brought by Alfa Group. However, Ukrainian courts did begin to find in Telenor's favor, and Alfa Group dropped a number of lawsuits in late 2007.[75]

In the dispute, the Ukrainian government occupied an awkward space between censuring the judiciary for eating away at Telenor's property rights and distancing itself from the conflict. In 2006, three members of Parliament from eastern Ukraine, a region with considerable Russian sympathies, argued that three appeals court judges had "deliberately pass[ed] an illegal sentence

[72] Ukraine had only vague laws on joint-stock companies at this time. The clearest law was that shareholders' meetings require the presence of owners of at least 60 percent of the firm's shares. Interview, think tank, Washington, D.C., 2012.

[73] "Prosecutor General's Office opens criminal case," *Ukraine Business Weekly*, 10 October 2006.

[74] "US Federal Court grants Telenor motion, holds Altimo in contempt, imposes fines and orders Altimo to sell shares," *Marketwire*, 20 November 2008.

[75] While the international ruling likely influenced the Ukrainian government's behavior, it did not stop all judicial mistreatment of Telenor: one Ukrainian court ruled that the New York arbitration was unenforceable in Ukraine, despite Ukraine's membership in the international convention on the enforcement of foreign arbitral rulings (October 2007).

or ruling" in favor of Telenor.[76] The result was a prosecution of the three judges – and not of Telenor. What is more, the case was shortly abandoned. Even Ukrainian government actors from the region with the greatest potential biases against Telenor did not pursue state action against Telenor itself, instead using domestic targets to score political points. At the other extreme, those government officials sympathetic to Telenor began to speak out on the firm's behalf. For example, the vice prime minister referred to Telenor when he said, "the situation in Ukraine has reached absurdity when any district court can determine the fate of a serious strategic enterprise."[77]

Ultimately, the Ukrainian government refrained from taking actions tantamount to expropriating Telenor. In contrast to the situation in Russia, the Ukrainian government never froze Telenor's assets, and the government made some efforts to rectify injustices dealt Telenor through the judicial system. In fact, despite the intense years of conflict in 2006 and 2007, Telenor's profits from Kyivstar in 2007 were US$316 million, a year-on-year increase in profitability of 54 percent.[78] The underlying conflict ended when Telenor and Alfa Group came to an understanding in 2009 and merged their Russian and Ukrainian ventures.[79]

Norwegian Collective Efforts

Like the US investors advocating on OPIC's behalf around the same time, Norwegians were neither the largest nor the most prominent national investor group in Ukraine. But, if Telenor had exited the Ukrainian market, two powerful Russian firms – Alfa Group and MTS – would have controlled Ukraine's telecommunications industry. Even Russian-sympathetic politicians in Ukraine oppose deals that would cause Russian ownership of an entire industry. Low FDI national diversity, within the broader economy and certainly within the industry, set the stage for effective Norwegian activism on Telenor's behalf.

Norwegian actors in Ukraine were for many years committed to making their presence known as a national group. In 2004, before Telenor's conflict with Alfa Group had gotten underway in Ukraine, but when spillover from the Russian conflict seemed likely, Telenor's top executives from Norway met with then-President Kuchma, who "marked how important it is for Ukraine to optimize bilateral relations with Norway."[80] The Norwegian ambassador and the Norwegian minister of trade and industry met with Ukrainian officials to

76 "Prosecutor General's Office opens criminal case," *Ukraine Business Weekly*, 10 October 2006.

77 "Telenor supports anti-raiding commission of Ukrainian government," *The Ukrainian Times*, 14 March 2007.

78 "Ukraine: Telenor profit exceeds US$316mn," *Emersk Ukraine News* (via Sostav.ua), 25 July 2008.

79 The Ukrainian Anti-Monopoly Commission reviewed and approved the merger after responding to an appeal from another mobile operator in Ukraine.

80 "Kuchma orders to open Ukrainian embassy in Norway in near future," *Ukraine Business Report*, 30 January 2004.

discuss, among other subjects, "prospects for Kyivstar's development."[81] A variety of private Norwegian investors were present at these meetings, including a producer of farm equipment, a fish exporter, and a ship-building firm, all of which had made major investments in Ukraine but none of which were involved in Telenor or Kyivstar directly.[82] As in the case of US multinationals acting on behalf of OPIC, being Norwegian suggested enough similarities for these firms to offer a common front to the Ukrainian government. Kuchma subsequently opened a Ukrainian embassy in Norway.

As the Telenor dispute progressed, Ukraine's esteem for Norwegian investors was challenged. In 2007, signs appeared on Kyiv streets and outside Telenor's offices that read "Norwegians! Respect Ukrainian Laws!!" and "Norwegians, go home!"[83] An Alfa Group document soon emerged, entitled "Logical Rationale for the Information Campaign under the Kyivstar Contract," that read in part: "in order to break the existing stereotype whereby Western business and, in particular, Norwegian business always plays fair, an information wave of negative publicity should be started."[84] An accompanying spreadsheet suggested that Alfa Group's Ukrainian subsidiary should spend US$75,000 buying Ukrainian press coverage against Norwegians in just two months of 2007.[85] Consistent with the nationality shield theory, these attacks were not framed against Telenor in particular but against Norwegians as a national group. Even if Norwegians had not previously thought of themselves as a cohesive group, their detractors were willing to spend money characterizing them in such a way. Alfa Group's efforts aimed to isolate Norwegians from other nationalities so as to differentiate the legitimacy and importance of their contracts from those of others. In other words, Alfa Group thought that the nationality of capital could matter to the public and, in turn, to political perceptions of FDI. Also consistent with the nationality shield theory, interview respondents at firms from other home countries saw no reason to publicly coalesce with Telenor or Norwegians during these anti-Norwegian campaigns, though many were personally outraged by the sentiment.[86]

As Alfa Group's negative campaign made Norwegians' implicitly shared risks explicit, Norwegian firms and diplomats redoubled their efforts to shield Telenor's and their own contract sanctity. Building on their strong bilateral relations from before Telenor's conflict, Norwegian actors used both sticks and carrots with the Ukrainian government. With the Norwegian government

[81] Ibid.

[82] "Norway to boost investments in Ukraine," *Ukraine Business Weekly*, 29 March 2004.

[83] "How the Kremlin thawed a telecoms freeze in Siberia," *The Evening Standard (London)*, 17 November 2008, 29.

[84] Kramer, Andrew, "Russian Company accused of buying press coverage," *New York Times*, 14 March 2007. It has not been uncommon for firms to buy press coverage in other countries of the former Soviet Union.

[85] Ibid.

[86] Interviews (4), US, French, British, and Swedish firms, Ukraine, 2009 and 2011.

as a co-author, Telenor publicly petitioned the Ukrainian government to investigate the "objectivity, impartiality, and independence of judges" regarding their "interference with good corporate governance and business morals."[87] At the same time, Norwegian interests formed the Norwegian Chamber of Commerce, highlighting that Ukraine's market "could be very promising not only in the area of communications."[88] These examples of co-national lobbying and diplomacy are the tip of the iceberg of efforts that occurred regularly behind closed doors from 2005 to 2009.[89]

Low FDI national diversity gave the Ukrainian government incentives to keep Telenor invested in the country, and Norwegian actors made it clear that Norwegian investment and Norway's good relations with Ukraine were at stake if the Ukrainian government took adverse action against Telenor. In the context of these pressures counteracting Alfa Group's influence, the Ukrainian government ultimately refrained from contract breach.

Considering Alternative Explanations

Telenor's Ukrainian conflict ended during the worldwide financial crisis, when FDI into emerging economies was on the wane. With fewer alternate options for FDI going forward, the Ukrainian government was surely interested in retaining investors. Thus, the financial crisis may have exacerbated the constraints under which the Ukrainian government acted. Nevertheless, the history of the dispute demonstrates that breach was possible – some judges along the way certainly flirted with breach. And nationality played a central role in the dispute's framing and in protests by and on behalf of Telenor. Thus, while the amount of FDI in Ukraine likely played a role in the dispute's resolution, the evidence strongly suggests that nationality did as well.

Another alternative explanation for Telenor's intact contract is that it received support from other European countries' diplomats or firms, since it is an investor from Europe, albeit not the European Union. Over the 2000s, the European Business Association (EBA) had grown to represent the interests of investors into Ukraine originating from across Europe. Telenor is a member of the EBA and its top executives in Ukraine have served on its board. In interviews, executives at two prominent European firms said that the EBA is willing to advocate on behalf of individual firms, mentioning Telenor as one example. Were this true, it would tend to undercut the argument that co-national collective action and not multinational collective action was an important determinant of the outcome of Telenor's contract dispute.

[87] "Telenor asks authorities to investigate outcome of 11 rulings of Ukrainian courts," *The Ukrainian Times*, 14 February 2007.
[88] "Norwegian-Ukrainian Chamber of Commerce established," *Comtex News Network, Hugin AS*, 21 November 2008.
[89] Interviews (2), government officials, Ukraine, 2009.

In fact, top administrators at the EBA were clear in interviews that the EBA does not advocate on behalf of particular firms, and it did not advocate on Telenor's behalf.[90] These administrators carried out the work of the EBA, by writing letters to officials, maintaining government contacts, facilitating meetings, and providing the EBA's public face in Ukrainian and expatriate media. That EBA staff did not see the EBA as a forum for particular firms to resolve their grievances with the government reveals a disparity between certain investors' beliefs about the EBA's activities and what the association actually does. It is possible that individual executives advocated on Telenor's behalf thanks to government connections facilitated by the EBA, but this advocacy would have been isolated and undercut by the EBA's deliberate inaction on behalf of Telenor.

For example, in 2008 the EBA set up a number of working groups on corporate raidership, the crux of the problem facing Telenor.[91] The EBA president, however, specified to the Norwegian press that EBA efforts against raidership were not on Telenor's behalf.[92] The equally multinational Chamber/ACC worked together with the EBA to lobby the Ukrainian Rada for legislation codifying shareholder rights and closing loopholes that had facilitated raidership. Both organizations consider the legislation's adoption a great success story.[93] Nevertheless, the head of Telenor's operations in Ukraine stated plainly that this legislation "does not directly influence [their] conflict."[94]

Telenor's experiences provide a good illustration of the comparative advantages of multinational investor associations as opposed to nationality-based associations. Investors from a variety of home countries share interests in certain kinds of business-friendly policy and can come together to lobby around issues like broad-based legislation. But multinational investor associations shy away from individual firms' contract disputes. The political, strategic, and diplomatic background to a national group's contract sanctity emphasizes bilateral ties and downplays the relevance of a particular breach to multilateral actors. Because member firms of different nationalities do not share the same determinants of contract sanctity, they do not share a general interest in expending resources on each other's contract disputes. In an interview at a Ukrainian subsidiary from a small Western European home country, the CEO lamented that there was no European Union-tied lobbying group, let alone an EU "embassy," that would represent firms from small countries in their contract disputes.[95]

[90] Interviews (3), EBA, Ukraine, 2011.

[91] From many observers' point of view, Alfa Group's actions toward Telenor amounted to raidership: Alfa Group sought to change the balance of power in its partnerships with Telenor, with the ultimate intention of pushing Telenor to sell out so that Alfa Group could merge the Russian and Ukrainian operations.

[92] "Ukraine: Telenor accuses Altimo of raid attempt," *Esmerk Norway News*, 10 April 2008.

[93] Interviews (4), American Chamber of Commerce and EBA, Ukraine, 2009 and 2011.

[94] "New law on joint-stock companies not to settle conflict," *Ukraine Business Weekly*, 13 October 2008.

[95] Interview, manufacturing firm, Ukraine, 2009.

One interpretation of the outcome of Telenor's conflict could be that the Ukrainian government did breach a foreign firm's contract: that of Russia's Alfa Group. From the point of view of Alfa Group, and other Russian actors that likely advocated on its behalf behind closed doors, the Ukrainian government's refusal to support its claims outright could be a violation of at least informal government commitments to the firm. The wholly different desires of Norwegian and Russian firms in this case support the point that all foreign firms cannot be considered as a single entity: interpretations of government actions can vary by investor national origins, just as contract risks vary by national origin. Because international courts validated Telenor's claims, the choice to relate the case from Telenor's point of view aligns with the most objective understanding of the Ukrainian government's actions. That the Ukrainian government showed restraint toward Telenor's contract goes to show that a firm from a major investor home country like Russia may not have sufficient leverage to negate a small national investor group's contract sanctity.

A COMMON THREAT BUT CO-NATIONAL ACTION

The nationality shield theory proposes that national origin is a key determinant of resources to fight government breach of contract. In a situation where threats to contract sanctity extend across national groups, the theory implies that national groups facing common threats still defend themselves behind their own shields. Even in situations where cross-national efforts might logically be thought to be helpful to firms, co-national action should dominate, because co-national resources are best suited to advocate for contract sanctity. A common threat to contract sanctity presented itself in Ukraine in 2005, when the Orange government threatened to nationalize and reprivatize assets across the economy. Nevertheless, it was nationality-tied resources that provided a ready source of powerful home-country support and lobbying efforts for foreign firms to successfully deter breach in Ukraine.

In January 2005, the Orange Revolution produced a coalition government with Viktor Yushchenko as president and Julia Tymoshenko as prime minister. In February, Tymoshenko created headlines when she announced that the government had a list of "3,000 cases of illegal privatizations" that it would nationalize and reprivatize. Tymoshenko proclaimed, "We will return to the state that which was illegally taken from it."[96] The Finance Minister tried to clarify this statement, saying that the list of 3,000 privatizations "may increase, but this does not mean a declaration of war against all private owners."[97]

[96] "Daily Alert – PM sparks unease over sell-off review," *Emerging Markets Daily News*, 17 February 2005.

[97] "Ukrainian finance minister plays down mass reprivatization fears," *BBC Monitoring Ukraine and Baltics*, 18 February 2005. Taken from a televised interview on Ukrainian ICTV television. Reported by *Interfax Ukraine*.

A week later, however, Members of the Rada proposed legislation to legalize nationalization that meets "the social needs of the state and municipalities," omitting consideration of Ukraine's international legal obligations to foreign investors such as those incurred through Ukraine's BITs.[98]

A local observer's summary of the reprivatization threat was apt: "Tymoshenko is still behaving like a revolutionary and is playing the populist card."[99] Reprivatization was popular indeed. A 2005 poll found that 71 percent of Ukrainians supported Tymoshenko's plan to revise privatization results, with 81 percent in support in the populous and cosmopolitan Kyiv and Central Ukraine.[100] This sentiment was largely a reaction to the Kuchma government's notorious sales of state assets at fire sale prices to political insiders, leading a member of the Rada to lament, "[sixty percent] of Ukrainian industry has been sold for 2 billion hrivnyas [US$3.7 million]! What bureaucrats call privatization has in fact turned out to have been a brutal robbery of state property."[101] Indeed, backlash against legacies of corrupt, insider, and otherwise non-transparent privatizations are common across post-communist countries: in a 2006 regional survey, over 80 percent of 27,000 respondents from twenty-seven transition countries wanted their governments to demand additional payments from private owners ex post, resell property for higher prices in new tenders, or return property to state ownership.[102] Unskilled workers and individuals in post-communist democracies have been more supportive of reprivatization, which played to the populist base Tymoshenko developed during the Orange Revolution.[103] Tymoshenko found a moment in which she predicted she had the permissive space to act on incentives to breach – though, in fact, she was later proven wrong.

President Yushchenko protested that Tymoshenko's plan sounded like "a full revision of privatization processes in Ukraine," but reprivatization's popularity and Ukraine's need for cash to fund its budget kept him from wholly opposing it.[104] In the weeks that followed the original announcement, Yushchenko assured reporters that the "exhaustive list" of privatizations to be reviewed would be not zero but forty, then "several dozen," then "about twenty" privatizations.[105] Nonetheless, the government never made clear the criteria that

98 "Nationalization legislation proposed," *Interfax Ukraine*, 25 February 2005.

99 "Ukraine's Yushchenko slaps down PM on privatization threat," *Agence France Presse*, 18 February 2005.

100 Poll in Ukraine, by the Kyiv International Institute of Sociology. "Poll: 71.3% of Ukrainians back privatization," *Interfax News Service*, 14 May 2005.

101 "Robbery of state property," *Interfax Ukraine*, 24 April 2003.

102 Denisova et al. 2009, 2012; Wellhausen 2010.

103 Wellhausen 2010. Workers in foreign firms have more to lose from privatization revision and are more likely to oppose it.

104 "Yushchenko, Tymoshenko united on reprivatization," *Interfax Ukraine*, 22 February 2005.

105 "Ukraine to draft 'exhaustive list' of companies for reprivatization," *BBC Monitoring Ukraine and Baltics*, 15 February 2005. "Yushchenko, Tymoshenko united on reprivatization," *Interfax Ukraine*, 22 February 2005. "Ukraine to review privatization of 20 major firms this year: deputy

would put a privatized asset on the list of firms to be reviewed, nor did it make the list public.

With no clarity as to what it meant for a privatization to be illegal, or how follow-on owners would be held accountable for owning property that was once distributed illegally, foreign firms across the economy felt threats to their contract sanctity. Much FDI entered Ukraine via privatization tenders. When it did not, FDI can often be traced back to privatized assets through a trail of mergers and acquisitions made over many years. Tymoshenko's threats in 2005 implicated privatizations made as long ago as 1992. "Horrified investors" worried that that broad reprivatization would "send a very bad message that the old government giveth and the new government taketh."[106] With "the property rights of thousands of enterprises in limbo," the mechanism of FDI exit and diversion operated in many national groups of investors.[107] Aggregate FDI was 14 percent lower in the first six months of the Orange government than it had been under the Kuchma regime a year earlier.[108] Thus, when the threat to contract sanctity was perceived as universal, conventional wisdom about FDI exit held true: foreign firms across the whole economy re-evaluated their strategies and decreased or diverted planned investments. This imposed heavy costs on Ukraine's Orange government, which needed tax revenue and economic growth to keep the country afloat and fulfill the coalition's development promises.

Although risks to contract sanctity were common across nationalities, investors and their representatives framed their frustrations in national terms and protested using national resources. For example, in June 2005, Yushchenko reassured Czech investors at a special forum on reprivatization attended by the Czech President Vaclav Klaus. Ukrainian television aired a program on German investors' fears of reprivatization and then one on British investors' fears.[109] The

PM," *Agence France Presse*, 26 February 2005. Yushchenko also clearly alluded to the Yukos takeover in Russia, saying that Ukraine would review privatizations "in a very different way." "Ukraine's Yushchenko slaps down PM on privatization threat," *Agence France Presse*, 18 February 2005.

106 Chazan, Guy, "Kiev's Orange Revolution is soiled – Ukrainian cronyism scandal, symbolized by steel plant, divides new government," *Wall Street Journal Europe*, 12 September 2005. "Q&A with pro-Ukraine investment banker Michael Bleyzer," *Kyiv Post*, 27 January 2005. Bleyzer explained what he would do regarding reprivatizations: "I would take one or two showcases and review them, trying to be fair and objective. In some cases, getting additional compensation would be sufficient if there is enough assurance that that would have been the market price had the tender been run transparently; in other cases it is possible that re-tendering them would be the option. However, this is a less attractive option, as it will send a very bad message that the old government giveth and the new government taketh. So I would certainly be very careful not to do a lot of those things."

107 Aslund, Anders, "Betraying a Revolution," *The Washington Post*, 18 May 2005.

108 "Post-revolution Ukraine still awaits business Shangri-la," *Agence France Presse*, 16 November 2005.

109 "German investor in Ukrainian titanium plant fears reprivatization," *BBC Monitoring Ukraine and Baltics*, 24 July 2005.

German and British ambassadors gave independent public statements demanding protection for their nationals' property; it is reasonable to assume that similar pressure from other ambassadors occurred behind the scenes. In July, a US assistant secretary of state testified on the threat of reprivatization before the US House of Representatives Committee on International Relations. The assistant secretary later visited Ukraine and participated in a specially organized group of US firms and diplomats that lobbied the Ukrainian government over threats of breach.[110] The USUBC took a strong stand against reprivatization and participated in behind-the-scenes negotiations.[111] British, French, German, and Israeli national investor associations came to imitate the USUBC in the mid-to-late 2000s, lobbying the Ukrainian government on their investors' behalf. National rather than multilateral advocates organized and pressured the Ukrainian government to commit to the sanctity of privatization contracts.

One set of co-nationals did interpret reprivatization as a more particular threat directed at their national group. Russian firms account for significant amounts of FDI into large, privatized Ukrainian assets, several of which were sold early in Ukraine's transition under non-transparent circumstances. Russian firms organized along national lines, framed reprivatization as an issue of discrimination against Russian investments, and drew on Russian political and diplomatic support to advocate for their property rights. The Russian Duma opened an investigation into the implications of Ukrainian reprivatization for Russian investors the day after Tymoshenko threatened to reprivatize 3,000 firms. Duma members claimed that the privatization review was motivated by anti-Russian sentiment and argued that Russia should take steps to defend its interests.[112] In lobbying Russian politicians for support, Russian firms framed reprivatization as "very harmful to the interests of Russia."[113] Russian President Vladimir Putin and Russian firms representing a variety of industries soon met with President Yushchenko, who promised that "nothing will happen to the lawfully acquired assets of Russian oligarchs."[114] Given the uncertainty over what it meant for a privatization to be lawful, this promise likely did little to assuage Russian concerns.

A reprivatization list was leaked in May 2005, four months after Tymoshenko's original announcement. This confirmed Russian fears, as four Russian-owned firms, in petrochemicals, steel, mining, and aluminum, were the only foreign firms among the twenty-nine privatized firms listed.[115] In the first

110 Interviews (2), Washington, D.C., 2011.

111 Interview, USUBC, Washington, D.C., 2011.

112 "Russia moves to safeguard interests from Ukraine 'de-privatization'," *Agence France Presse*, 18 February 2005.

113 "LukOil, TNK-BP, Tatneft, Alliance Group asking Russian Prime Minister Fradkov to protect their interests in Ukraine," *Ukrainian News*, 19 April 2005.

114 "The fate of Russian investments in Ukraine," *Moskovskii Komsomolets*, No. 55, 16 March 2005. "Russian companies in Ukraine are kept on a short leash," *Vedomosti*, 28 April 2005.

115 Wilson 2005: 166.

major repossession of privatized property, a Ukrainian court ordered the renationalization of a Russian-owned aluminum plant. The head of a powerful Russian association put this action in bilateral terms: "this reprivatization is clearly anti-Russian … We do not hear anything about European or American assets."[116] Rather than using the worries of investors of other nationalities as a means to support the Russian cause to ensure contract sanctity, key Russian actors framed reprivatization in terms of bilateral animosity between the Western-oriented Orange government and Russia.

The difference between Russian and other investors' perceived contract sanctity became clear with the nationalization and reprivatization of Ukraine's largest steel mill, Kryvorizhstal.[117] In 2004, Kuchma's government sold the steel mill for US$800 million to prominent Ukrainian oligarchs who invested via Cypriot firms. This price was about half of the high bid of US$1.5 billion put forth by Mittal Steel.[118] The Orange government repossessed the mill without compensation in 2005, fulfilling a promise that had been part of both Yushchenko's and Tymoshenko's election campaigns. Yushchenko, for example, had argued that Kryvorizhstal "was not privatization, but the humiliation of honest business; it humiliated the government."[119] The steel mill was resold in October 2005 in a transparent auction, televised with much fanfare.[120] Mittal Steel offered the unexpectedly high winning bid of US$4.8 billion.[121]

Russian investors protested Kryvorizhstal's reprivatization, worrying that it would lead to more actions against similar, large-scale Russian investments that often involved oligarchs and Russian–Cypriot firms. Yanukovych, the leader of the Russian-sympathetic Party of the Regions, argued that the Kryvorizhstal's reprivatization had a "negative effect on the image of Ukraine," and that "any step under this very unpopular word reprivatization will definitely affect the

[116] "Russian companies in Ukraine are kept on a short leash," *Vedomosti*, 28 April 2005.

[117] The mill's name was changed shortly thereafter to Kryvyi Rih, but it will be referred to as Kryvorizhstal for the ease of the reader.

[118] States regularly reserve the right to discriminate against foreign investment at the border. While rejecting Mittal Steel's bid perhaps walks the line of breaching commitments to fair treatment to foreign firms, it falls outside of the question considered here – breach of contracts and commitments made to existing foreign firms.

[119] "Yushchenko: Reprivatization policy would have discredited new government," *Associated Press Newswires*, 6 October 2005. In a televised presidential debate, Yushchenko said, "When we are divided, the authorities can steal Kryvorizhstal in one night, and we'll have to listen for twelve months to the fairy-tales of this government." "Ukrainian presidential candidates clash in TV debate," *BBC Summary of World Broadcasts*, 15 November 2004. Source: *UT1* (television station). See also Aslund, Anders, "Betraying a Revolution," *The Washington Post*, 18 May 2005. "Yushchenko: Reprivatization policy would have discredited new government," *Associated Press Newswires*, 6 October 2005.

[120] "The Great Giveaway Revisited," *Kyiv Post*, 25 September 2008.

[121] The Ukrainian government had hoped to sell Kryvorizhstal for US$2 billion at best; its windfall price gave the government new budgetary breathing room. Wilson 2005.

image of Ukraine and push away investors."[122] In contrast, non-Russian executives in Ukraine saw Kryvorizhstal's reprivatization as a signal of a new commitment to transparency and anti-corruption. The publisher of the English-language newspaper of record in Ukraine gave voice to the distinction non-Russian investors made between Kryvorizhstal and the broader reprivatization threat, writing,

> Kryvorizhstal became a symbol of the corruption of Ukraine's old regime ... Yushchenko and other speakers made the lucrative steel mill a talking point of the Orange Revolution, promising to right the injustice ... After all the controversy over reprivatization this year, the government showed that it has the right values – transparency, honesty, and private enterprise – and that it knows how to do things correctly. Congratulations to Mittal and to the government.[123]

Reflecting on the reprivatization some years later, foreign executives in Ukraine cited the US$4.8 billion price as an important beacon for major multinational entrants from Western European countries, which contributed to Ukraine's FDI boom. In the next years, for example, the Austrian bank Raiffeisen International invested US$1 billion and the French bank BNP Paribas invested $360 million.[124] With Mittal Steel's entry and such large, associated investments concentrated in the hands of major Western European multinationals, Ukraine's FDI national diversity dropped precipitously and remained low relative to the previous trend (see again Figure 5.1).[125]

The decrease in FDI national diversity helped to create an environment beneficial to all national groups threatened by broad reprivatization threats, including Russian investors. Now that Kryvorizhstal had been rectified, President Yushchenko faced mounting pressure from international actors to stop the reprivatization campaign. Additionally, with new capital to rely on to contribute to the government budget and the Ukrainian economy, Yushchenko's motives in supporting limited reprivatization were satisfied. New, major foreign firms were taking a chance on the Ukrainian government's commitment to contract sanctity, and Yushchenko delivered accordingly.[126]

One month after Kryvorizhstal, Prime Minister Tymoshenko took steps to nationalize and reprivatize another huge plant in the eastern city of Nikopol. But Tymoshenko was accused of merely transferring the plant from one clan to another without raising more revenue for the state or making the allocation of

[122] "Yanukovych cautions cabinet against reprivatization as it confuses investors," *Ukrainian News*, 24 December 2007.

[123] Sunden, Jed, "Welcome to Ukraine, Mittal Steel," *Kyiv Post*, 26 October 2005.

[124] "2008 Investment Climate Statement – Ukraine," US Department of State.

[125] Mittal Steel made its investment through a German subsidiary, growing the German share of FDI considerably (see subsequent sections for a consideration of Mittal's multiple nationality claims).

[126] Yushchenko was known to have a deep commitment to global markets, which he demonstrated while Chairman of the National Bank of Ukraine from 1993 to 1999.

property rights any more fair.[127] Yushchenko declared that "high officials had begun to direct events in favor of corporate interests" and that "everybody should get lost," dismissing his cabinet, removing Tymoshenko from office, and ending the Orange coalition government.[128] Yushchenko then canceled all reviews of privatization deals. If the leaked list was correct, three Russian firms with questionable assets directly benefitted from the abandonment of reprivatization. Even though Russians as a national group had been relatively unsuccessful in their own advocacy, Russian firms nevertheless gained contract sanctity within an environment of low FDI national diversity.

CO-NATIONALITY AMONG "TAX HAVEN" FIRMS

Kryvorizhstal was, indeed, a foreign-invested enterprise expropriated without compensation. Nine major shareholders within the purpose-built Ukrainian Investment and Metallurgical Union (IMU) bought the plant. While firm ownership in the region can be notoriously difficult to trace, several of these shareholders were incorporated in Cyprus.[129] Nevertheless, the consortium had close ties to the Kuchma administration, and ultimate control sat with two prominent Ukrainian oligarchs: Viktor Pinchuk, Kuchma's son-in-law, and Rinat Akhmetov, a Kuchma ally.

Kryvorizhstal's ownership exemplified a particular kind of offshore incorporation, known as "round-tripping," that occurs in a number of emerging economies. Round-tripping occurs when nationals invest capital in firms incorporated abroad and then reinvest in their countries of national origin. Round-tripped investors can withdraw funds just as any foreign investor would do, giving them a fundamental source of leverage over host governments interested in access to mobile capital. The threat of withdrawing their own capital did Kryvorizhstal's owners little good, however, as the threat to their contract sanctity was nationalization.

[127] Viktor Pinchuk, previous Kryvorizhstal owner and son-in-law to former president Kuchma, said Tymoshenko's actions were "show business, seizing property from the wealthy, and in particular me." At this time, Tymoshenko also began reprivatizing a chemical-fertilizer plant owned in part by a Western firm, Worldwide Chemical LLC. This fell by the wayside after Tymoshenko was removed as prime minister. Bellaby, Mara D, "Ukrainian tycoon hopes sacking of government will end all attempts to seize his businesses," *Associated Press Newswires*, 14 September 2005.

[128] Chazan, Guy, "Kiev's Orange Revolution is soiled – Ukrainian cronyism scandal, symbolized by steel plant, divides new government," *Wall Street Journal Europe*, 12 September 2005. Bellaby, Mara D, "Ukrainian tycoon hopes sacking of government will end all attempts to seize his businesses," *Associated Press Newswires*, 14 September 2005.

[129] The nine shareholders were: the Interpipe Corporation and the Nyzhnedniprovsky pipe plant, both controlled by Viktor Pinchuk; two coking and chemical plants (Avdiyivka and Markokhim) owned by System Capital Management, which was controlled by Rinat Akhmetov; the Ukrainian-Cypriot company Bipe Co. Ltd; two banks (Dnipro Bank and Ukrinvest Bank, a part-owner of UkrSibBank); the insurance firm Aura; and the metallurgical combine Azovstal. Pinchuk and Akhmetov are popularly understood to have been Kryvorizhstal's owners. "Cabinet starts to re-privatize Kryvorizhstal," *Business Report Ukraine*, 7 February 2005.

Firms incorporated in Cyprus but with Ukrainian capital have a sort of hybrid nationality, with ethnic ties to the host country and legal ties to Cyprus. The theoretical expectation is that such firms have access to a set of resources similar to other Cypriot-Ukrainian hybrids, related to Cypriot firms, but different from other nationalities of firms. In particular, Cypriot-Ukrainian firms should be keenly interested in each other's contract sanctity as, indeed, they share a unique combination of foreign and domestic determinants of contract risks. In terms of home country resources, incorporating in Cyprus gives firms access to the Cyprus–Ukraine BIT that round-tripped Ukrainian firms have used to publicly sue Ukraine several times.[130] But diplomats from tax havens like Cyprus have proven unwilling to take public stands on behalf of their "adopted nationals." As with traditional foreign investors, the expectation is that the Cypriot-Ukrainian firm behind Kryvorizhstal was unsuccessful in arranging any sort of cross-national action on its behalf.

There was outcry in the Ukrainian oligarch community over the government's reprivatization plans, as typified by their support for the status quo during the Orange Revolution. As these oligarchs are the actors responsible for many Ukrainian-Cypriot firms, we can presume that this group of investors felt a shared sense of risks to contract sanctity. But no international diplomats came to the owners' aid, nor did foreign investors of other national origins support the Cypriot-Ukrainian owners' protests. This lack of support from other foreign investors came as a surprise to Kryvorizhstal's Cypriot-Ukrainian owners, as made clear in an interview with its most prominent oligarch owner:

(INTERVIEWER): … [Kryvorizhstal] will be sold in two weeks' time. And your predictions that no one will take part in the privatization are not coming true.

(PINCHUK): Let's look at what will happen on 24 October. It seems to me that the closer it gets to the tender, the more serious investors will start to ponder the situation. … There have been a whole number of violations around the reprivatization of the combine.

(INTERVIEWER): There is something you're not saying – what might prevent the repeat sale of Kryvorizhstal?

[130] The case that first allowed round-tripped firms to access BITs was in fact brought against Ukraine: a Lithuanian-incorporated firm, owned by Ukrainian nationals, was allowed to sue the Ukrainian government under the Lithuania-Ukraine BIT in 2004. The *Tokios* case came about when a Lithuanian-incorporated printing firm, owned by a Ukrainian political refugee, had its Ukrainian accounts frozen and its offices subject to repeated police and tax enforcement raids. This occurred under the Kuchma regime, after the firm printed a book about then-opposition leader Tymoshenko just prior to the 2002 parliamentary elections. Tokios took the case to international arbitration at ICSID, where the arbiters allowed jurisdiction under the Lithuania–Ukraine BIT, writing, "the ICSID Convention contains no inchoate requirement that the investment at issue in a dispute have an international character in which the origin of the capital is decisive." *Tokios Tokeles v. Ukraine (ICSID ARB/02/18)*, Decision on Jurisdiction, April 29, 2004, Paragraph 82. This right has been challenged in at least one case, as reported in the article: "In unpublished ruling, arbitrators find that Swiss company's ties to Switzerland are too tenuous to deserve protections of investment treaty; one-off cross-border purchase of receivables in Slovak Republic is not a protected investment," *Investment Arbitration Reporter*, 14 April 2011.

(PINCHUK): The investors must stop and think. Our lawyers have sent the investors a letter describing the situation.
(INTERVIEWER): To all potential investors – Arcelor, Mittal?
(PINCHUK): Yes, all of them! We have set out the current position. The case is at the Supreme Council. Say you want to buy a flat but you are told that this flat is the subject of a court case. Will you risk buying it? I don't think so.[131]

Despite Pinchuk's and other owners' efforts in both the media and legal forums, traditional foreign firms saw Kryvorizhstal as tied up with another set of contract risks. Mittal Steel, Arcelor, and other major steel firms vied for the asset freely and without hesitation. Certainly, the risks faced by this hybrid nationality differed from those of traditional foreign firms. For Kryvorizhstal's Cypriot-Ukrainian owners, the exit and protest threats their foreignness offered were insufficient to deter their own breach.

TRUE MULTINATIONALS

Beyond cases of incorporation in tax havens, some multinationals do have origins in two or more home countries. The steel giant ArcelorMittal and its subsidiary in Ukraine provide a good example of this. Mittal Steel, a British firm, bought Kryvorizhstal for US$4.8 billion. That investment was made through a major German subsidiary. Later, Mittal Steel merged with Arcelor, a French firm with strong ties to the French state. By 2011, considerable investment in their Ukrainian subsidiary also came from Luxembourg. Thus, ArcelorMittal's operations in Ukraine have ties to and potential claims on multiple national groups of investors and multiple home governments: France, the United Kingdom, Germany, and Luxembourg.[132] What does this complicated nationality mean for ArcelorMittal's ability to ensure its contract sanctity in Ukraine?

On one hand, a firm like ArcelorMittal with multiple home countries is open to more sources of risks to contract sanctity than a traditional, one-home foreign firm, because it is sensitive to contract risks emanating from more than one bilateral relationship. This broader exposure to contract risks can alienate some of the firm's (various) co-nationals, making them unwilling to participate in collective lobbying efforts if the multiple-home firm's dispute is seen as too far removed from their experience. On the other hand, diplomats from the different home countries retain incentives to support a multiple-home firm, since the presence of multiple homes does not change a diplomat's interest in the fortunes of a firm that provides employment, taxes, and revenues in its country. However,

[131] "Ukrainian top businessmen call for end to reprivatization," *BBC Monitoring Ukraine and Baltics*. Source: *Ukrayinska Pravda*, 18 October 2005.
[132] Not to mention that Lakshmi Mittal, the owner of Mittal Steel and then CEO of ArcelorMittal, is of Indian heritage, and Mittal Steel was originally an Indian firm. A prominent Ukrainian journalist attributes some of Mittal's problems, including violence at the Kryvorizhstal mill, to "xenophobia against Indians." Interview, think tank, Ukraine, 2009.

if other home country governments will also advocate on the multiple-home firm's behalf, diplomats do have an incentive to free ride on others' efforts.

ArcelorMittal has proven able to counteract diplomats' incentives to free ride and received consistent diplomatic support, while various co-national firms proved willing to get involved in advocacy efforts around one contract dispute but distanced themselves from another. The difference came down to a dispute with which other firms could identify and a dispute that was wholly tied up in characteristics of the steel industry and the particular privatized asset. Thus, this case provides evidence that other forms of firm differentiation – here, along the lines of industry and asset history – can interfere with firms' willingness to lobby on behalf of a co-national. Nevertheless, the consistency of diplomatic efforts goes to show that home country resources are still consequential for firms' contract sanctity even in the absence of co-national firm lobbying.[133]

Diplomacy and Lobbying by Co-national Firms

Foreign firms have been frustrated by the non-payment of value-added tax (VAT) refunds in Ukraine since the late 1990s, but the government's need for cash during the global financial crisis brought VAT arrears to new heights. In a VAT system, a government refunds VAT to exporters. In many countries, these refunds are simply a matter of accounting, and exporters do not actually advance money in the process. In Ukraine, however, money does change hands, and the government has repeatedly reneged on repayments. ArcelorMittal became, as its Ukrainian director put it, "the outright champion" of VAT arrears.[134] ArcelorMittal did not get VAT refunded from late 2009 to 2010, and it was also asked to pay its income taxes months in advance, leaving it a creditor to the Ukrainian government for US$500 million by mid-2010. Adding insult to injury was the fact that ArcelorMittal's domestic competitors received regular VAT refunds. ArcelorMittal called attention to this discrepancy in the business press: "We are witnessing the unfair treatment of international investors."[135]

The government's VAT arrears to ArcelorMittal accounted for 30 percent of the US$1.2 billion in outstanding VAT owed to its exporters by August 2010.[136] The total debt owed by the state to foreign firms, in VAT and advance taxes, was put at over US$3 billion.[137] Unsurprisingly, other foreign firms to whom VAT was owed advocated for themselves, just as ArcelorMittal did. The nationality shield theory, however, generates predictions about what firms without broken contracts

[133] Industry and asset history as forms of firm differentiation will be discussed further in Chapters 6 and 8.

[134] Stack, Graham, "Value-added tax system provides case study in corruption, favors," *Kyiv Post*, 3 June 2010.

[135] Ibid. Some of these competitors have round-tripped foreign capital.

[136] "State Tax Administration: Value-added tax bonds worth Hr 16 billion ready," *Interfax Ukraine*, 6 August 2010.

[137] "German investor sues Yanukovych," *Kyiv Post*, 15 July 2010.

do in response to another's contract breach. How did other foreign firms – without their own massive VAT arrears – react to this widespread breach?

In fact, a number of non-exporting foreign firms saw ArcelorMittal's VAT problems as a harbinger of threats to their financial relationship with the Ukrainian government. This common concern allowed ArcelorMittal to assemble effectively multilateral action thanks to its broad European identity. ArcelorMittal used the European Business Association (EBA) as a lobbying group on its behalf. Though the EBA generally rejects campaigns on behalf of a particular firm, ArcelorMittal's situation touched enough constituencies to overcome the EBA's reluctance.[138] ArcelorMittal also got multilateral players in Ukraine – including the European Bank for Reconstruction and Development, the World Bank, and the IMF – to lobby on its behalf; these organizations will advocate on behalf of contract disputes when pressed by members from several of their national constituencies.[139] As a result, Ukraine's 2009 IMF package included an uncharacteristically specific stipulation about VAT repayment, and, in 2010, the Ukrainian government acknowledged that non-refund of VAT "negatively impact[ed] Ukraine's difficult talks with the IMF."[140]

Home governments' pressure, however, may have made the difference in pushing the Ukrainian government to settle with ArcelorMittal. The British Embassy was a strong advocate.[141] The German embassy was also quite vocal in public and behind closed doors, providing evidence that ArcelorMittal's use of a German subsidiary did indeed carry with it access to resources reserved for German firms.[142] French President Nicolas Sarkozy intervened directly during President Yanukovych's state visit to France in 2010.[143] Shortly after that visit, the Ukrainian government offered and ArcelorMittal accepted US$215 million of discounted VAT treasury bonds.[144] It took until 2011 for

[138] The content of the issue, too, might drive the probability of cross-national action. VAT nonpayment got relatively close to what is often an investor association's wheelhouse – advocacy around corporate tax rates. When policy rather than particular breaches are concerned, multilateral action is more likely.

[139] Interviews (2), international organizations, Ukraine, 2009. For a deeper treatment of the role of international organizations in contract disputes, see Chapters 6 and 8.

[140] Stack, Graham, "Value-added tax system provides case study in corruption, favors," *Kyiv Post*, 3 June 2010.

[141] Interviews (2), British firms, Ukraine, 2009.

[142] Stack, Graham, "Value-added tax system provides case study in corruption, favors," *Kyiv Post*, 3 June 2010.

[143] Following the French intervention, ArcelorMittal CEO Lakshmi Mittal came to Ukraine and held a three-hour meeting with Yanukovych. Lavrov, Vlad, "ArcelorMittal becomes target after complaining about taxes," *Kyiv Post*, 25 February 2011.

[144] "State Tax Administration: Value-added tax bonds worth Hr 16 billion ready," *Kyiv Post*, 6 August 2010. ArcelorMittal was willing to accept the losses the bonds entailed: "Understanding the challenging situation the Ukrainian government is facing with VAT refunds, we have accepted that issuing the VAT T-bonds was a controversial but necessary compromise decision." "ArcelorMittal Kryviy Rih reports receiving VAT bonds worth Hr 1.7 billion from the state," *Kyiv Post*, 8 September 2010.

the VAT issue to be wholly settled, which ArcelorMittal confirmed only after the Ukrainian premier met with the head of the Parliament of Luxembourg.[145] Another of ArcelorMittal's home countries joined its many co-national firms and home-country diplomats of different nationalities in successfully advocating on the firm's behalf. This support suggests that firms would do well to acquire all the nationalities they can in order to amass resources to deter breach (Chapter 8).

Diplomacy Only

ArcelorMittal became the owner of Ukraine's largest steel mill. The Ukrainian government has an ongoing interest in ArcelorMittal's operations, as the firm employs over 50,000 people, it operates an asset with a social history that gives the firm a prominent place in Ukrainian politics, and it is the biggest economic player in one of Ukraine's less-developed regions. With disproportionate attention from the government, in a strategic industry, and with an immobile asset, conventional wisdom suggests that ArcelorMittal would likely face breach of contract (Chapter 2). Indeed, ArcelorMittal has faced threats to its contract sanctity in addition to the VAT arrears. In ArcelorMittal's more industry-specific contract disputes, other firms sharing ArcelorMittal's nationalities were unwilling to participate in collective action, as their sense of shared contract risks was weak. But ArcelorMittal's experience demonstrates that firms in vulnerable industries need not forego diplomatic support – even diplomatic support coming from a variety of home countries, none of which has total claim on the firm and each of which could free ride on the others.[146]

From 2007 to 2009, the Ukrainian government threatened to renationalize Kryvorizhstal a second time. The threats were couched in a series of regulatory rationales contesting ArcelorMittal's follow-through on clauses concerning local development that were written into the reprivatization agreement. At their core, however, these threats were a product of party politics. The head of the State Property Fund (SPF), the department responsible for Kryvorizhstal's sale to ArcelorMittal, was also the head of the Socialist Party. While the Socialist Party had been part of the Orange coalition in 2005, it afterward aligned with the Eastern-looking Party of the Regions, the party that lost out in the Orange Revolution and was unsupportive of Kryvorizhstal's reprivatization.[147] Under Socialist Party leadership, the SPF repeatedly threatened to renationalize

[145] "Government: VAT reimbursement to ArcelorMittal Kryviy Rih settled," *Interfax Ukraine*, 3 March 2011.

[146] Given ArcelorMittal's high sunk costs, protest is a considerably more viable means to impose costs on the host government than its own exit or incremental drawdown.

[147] In 2008, even the chair of the trade union committee of ArcelorMittal Kryviy Rih said that the investment should not be turned into "a pedestal for politicians … Somebody's fingerprints are seen in the situation." *Interfax Ukraine Business Weekly*, 22 July 2008.

Kryvorizhstal, alleging that ArcelorMittal had failed to fulfill contractual clauses to maintain salary levels and upgrade environmental and social services. Tymoshenko, now in the opposition, called the SPF's threats against ArcelorMittal "groundless and provocative" and led attempts to fire the SPF's head.[148] In 2009, the Rada did remove the leader of the SPF and replaced her with a politician loyal to Tymoshenko. The new SPF head confirmed that ArcelorMittal had fulfilled all investment obligations.[149] Respondents with close ties to top Ukrainian politicians were confident that behind-the-scenes diplomatic pressure on ArcelorMittal's behalf contributed to Tymoshenko's efforts to replace the head of the SPF.[150]

Nevertheless, the Ukrainian government, now led by the Party of the Regions, opened criminal cases against ArcelorMittal in 2010, accusing the firm of smuggling high-grade coal under low-grade customs codes. For ArcelorMittal to have done this would be logistically difficult, given the highly standardized (and physically enormous) coal shipments to its mill and the fact that the regional coalmines only provide certain qualities of coal.[151] This left local observers certain that domestic interests, still desirous of renationalization, lay behind the cases.[152]

The firms that had lobbied on ArcelorMittal's behalf when it came to VAT arrears distanced themselves from these other, acrimonious disputes. National investor associations did not speak out on ArcelorMittal's behalf, nor did the EBA. In general, foreign executives were privately sympathetic to ArcelorMittal, though one prominent executive chastised ArcelorMittal for being "very arrogant" in its dealing with the government.[153] Yet top executives at firms in a variety of industries and of a variety of nationalities universally balked at the idea of getting publicly involved in these disputes.[154] While VAT arrears suggested shared risks to tax contracts, an issue relevant to all industries, these later disputes were viewed as industry-specific. In short, commonalities created by co-nationality were not enough to spur collective action among firms that perceived these risks to contract sanctity as particular to ArcelorMittal's unique situation.

148 Ibid.

149 "Business Briefs," *Kyiv Post*, 11 March 2009.

150 Interviews (2), Ukraine, 2009. Confidentiality requested.

151 Interviews (4), foreign and domestic law firms, Ukraine.

152 For its part, ArcelorMittal released this statement: "ArcelorMittal Kryviy Rih is supplying coal to Ukraine via big international trade on a long-term contract. We have already made supplies according to this contract this year, previous supplies were cleared by the Customs service without any remarks. We have not changed supplier or coal grade since then. We strongly reject any accusations and have already communicated all proofs of this to the customs." "Customs service opens smuggling case against ArcelorMittal Kryviy Rih," *Kyiv Post*, 15 September 2010. "Is Ukraine's Biggest Foreign Investor Now Safe?" *Kyiv Post*, 13 October 2010.

153 Interview, US firm, Ukraine, 2009.

154 There is no evidence of industry-based public support in local or expatriate-marketed media.

Yet even when industry considerations made co-national firms appear publicly indifferent, home country diplomats still came to the vulnerable investor's aid. In particular, diplomats from Luxembourg and France publicly demanded that Ukraine withdraw the cases. These demands seem to have had a direct effect on Ukraine's behavior. In a press conference after meeting with French President Sarkozy, Yanukovych said that the newly raised question of the state's nationalizing Kryvorizhstal "will most likely not reach court." The Ukrainian government soon dropped the criminal cases.[155]

Does ArcelorMittal present a case not of a multinational firm but, rather, of a truly European Union-origin firm? I contend that, no, diplomatic efforts on ArcelorMittal's behalf again came through national channels. The French president exerted leverage in one behind-closed-doors meeting, while the British, Germans, and Luxembourgians acted independently as well. Those involved in and closely observing the dispute in Ukraine noted – and sometimes lamented – the absence of EU efforts on the firm's behalf, as well as the absence of EU institutions in Ukraine to act on any firm's behalf.[156]

FIRMS AND THEIR DIPLOMATS

How do foreign firms protect themselves when host governments threaten to break contracts? Investor experiences in Ukraine show that support from home-country diplomats as well as coordinated lobbying among co-national firms have been important deterrents of breach of contract and means of achieving restitution. Moreover, co-national protest has been useful even when risks to contract sanctity are not clearly divided by nationality or when other characteristics, like industry or asset history, differentiate the contract risks facing co-national firms. The experiences of foreign firms in Ukraine over the last years suggest strongly that investors can and do turn to protest to preserve contract sanctity, and these resources are filtered by nationality.

However, the success and failure of foreign-firm protest depends not only on the advocacy itself but also on the FDI environment in which co-national actors undertake their campaigns. The entry and exit of national groups of foreign firms in Ukraine has changed the extent to which any one national group's protest presages costs sufficiently high to deter government breach of contract. With more investor nationalities at play through the late 1990s and early 2000s, the Ukrainian government had more room to undercut one group's contract sanctity without damaging its relations with other national groups.

155 "Is Ukraine's Biggest Foreign Investor Now Safe?" *Kyiv Post*, 13 October 2010.

156 Interviews (4), European Union-origin manufacturing firms (2); European Union-origin natural resources firm; European Union-origin legal firm, Ukraine, 2009 and 2011.

When fewer nationalities came to dominate the FDI environment in Ukraine after 2005, breach of contract proved a greater threat to the government's current and future access to FDI, enabling foreign firms to be more successful in deterring breach.[157] The ebb and flow of global capital has created contract risks for foreign firms in Ukraine while changing the government's ability to act in ways contrary to foreign firms' preferences and property.

[157] The worldwide financial crisis that hit Ukraine at the end of the decade likely made these dynamics even more salient, although Ukraine hosted levels of FDI unprecedented in its history.