

# Kluwer Arbitration Blog

## Enforcing Arbitration Clauses in Derivative Proceedings: Russia's Perspective

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In some legal systems, a shareholder of a company may act for the company in certain circumstances. When a shareholder is permitted to do so, questions may arise whether the shareholder may invoke (and is bound by) an arbitration clause in the contract. The arbitrability of derivative shareholders' actions is largely unclear in comparative legal terms [Loukas A Mistelis and Stavros L Brekoulakis (eds), *Arbitrability: International & Comparative Perspectives* (Kluwer Law International 2009) para. 15-18]. The approach to arbitrability may vary from country to country. For example, in *Frederick v. First Union Sec.*, a U.S. case in which a plaintiff-shareholder brought a derivative suit against a brokerage firm for allegedly participating in a scheme with company officials to manipulate the market and engage in insider trading. The court held that the plaintiff was compelled to arbitrate his claim because the agreement between the corporation and the brokerage firm, which established the brokerage firm's duties and pursuant to which the plaintiff had brought suit, contained an arbitration clause and the plaintiff was bringing suit on behalf of the company [Gary Born, *International Commercial Arbitration* (Second edition, Kluwer Law International 2014) 1480-1482].

In Russia, a shareholder may sue a company for rescission of a contract concluded between the company and a third party. Moreover, under some circumstances, a prosecutor may also bring the same action if the interest of the state (or a state entity) is breached. Obviously, if a contract contains an arbitration clause, the preliminary question that arises is whether or not a shareholder (a prosecutor) is bound by an arbitration agreement. This post reveals ambiguous approaches of Russian courts to the issue at hand.

### A Shareholders' Action

Russian courts take a view that a shareholder is not bound by an arbitration clause included in a contract. As a result, a party to the contract containing an arbitration clause may commence an arbitral proceeding, as a rule in a foreign arbitral institution, while a shareholder may bring an action to a Russian state court for the termination of the underlying contract (the parties to the contract are co-defendants). The result of the parallel proceedings might be antipodal – while, the arbitral tribunals have concluded that the contract is valid, Russian courts have always opposed such a

conclusion by deciding that the contract was null and void. Subsequently, when the arbitral award was rendered against the defendant, the defendant objected the recognition and enforcement of the arbitral award based on the court decision that declared the contract null and void.

This tactic is well known since 1998 when a Russian company tried to undermine the arbitral award rendered under the auspices of the Zurich Chamber of Commerce (Soinco SACI (Argentina) and Eural Kft (Hungary) v. Novokuznetsk Aluminium Plant (Russia)). The attempt failed both in Switzerland and in England. Since 2001 the tactic came to Russia and it is still successful – the Russian courts refused the recognition and enforcement of a foreign arbitral award. The Russian courts declared that public policy would be violated if a court recognized and enforced a foreign arbitral award based on a contract which had been declared void by a court.

During 2013-2015 Russian courts decided in at least seven multi-million LCIA/SCC cases that arbitral awards were not to be recognized and enforced due to the mentioned shareholders' tactic.

For example, in the case A40-50778/2015, there has been a chain of complex contracts between the Russian companies and a foreign company. The main object of the contracts was a joint activity in the domain of Greenhouse Gases emissions. Among others, the contract dated 7 March 2008 has been concluded. The contract contained an arbitration clause providing for the referral of disputes to the Stockholm Chamber of the Commerce (SCC).

The foreign company commenced an arbitral proceeding before the SCC. The foreign company sought damages of US \$119 million plus interest, for the termination of the contract.

It is unclear whether or not the Russian company took part in the arbitration proceedings, but two minority shareholders of the company, individuals, brought a lawsuit before the Arbitrazh Court of Moscow city (a state court). They sued the company, among others, for the rescission of the contract (case A40-184175/2013).

On 10 October 2014, the SCC has rendered an arbitral award in favor of the foreign company.

On 24 October 2014, the Arbitrazh Court of Moscow city rendered a decision in favor of the shareholders (case A40-184175/2013). The court declared that the contract dated on 07 March 2008 was null and void due to the violation of corporate law. During the course of the litigation, the foreign company objected that the arbitral award has a *res judicata* effect. The objection has been rejected because the parties to the arbitral and the litigation proceedings were different.

In 2015, the foreign company sought the recognition and enforcement of the arbitral award dated 10 October 2014 (case A40-50778/2015). The court rejected the recognition and enforcement of the arbitral award in Russia.

The court, as it has been demonstrated many times, noted: Russian public policy would be violated if a court recognized and enforced an arbitral award based on a

contract, which had recently been declared void by a Russian court. Moreover, the constitutional right of shareholders to judicial protection would also be violated.

The logic of Russian courts is plain. In the context of the arbitral award, the contract is valid. If the court granted the recognition and enforcement of the arbitral award (in case A40-50778/2015), it would mean that the court upheld the validity of the contract. However, the already existing court decision declared the contract void (case A40-184175/2013). Thus, the courts' conclusion would be conflicting. Russian law prohibits the existence of two decisions with different conclusions. As a result, the court refused the recognition and enforcement of the SCC arbitral award based on the public policy defense (Article V(2)(b) of the New York Convention 1958).

Finally, in the case A40-50778/2015, the foreign company may submit the cassation claim to the Supreme Court of Russia. While the Supreme Arbitrazh Court of Russia (which was abolished in 2014) recently declined to start the re-examination proceedings in six cases regarding the recognition and enforcement of LCIA arbitral awards based on the same approach, the Supreme Court of Russia is not bound by the previously rendered decisions. Quite the opposite, the Court has the authority and an opportunity to put an end to derivative shareholders' actions before Russian courts when there is a valid arbitration agreement.

### **A Prosecutor's Action**

A prosecutor may sue a company for the rescission of a contract if the Russian public interest has been violated [Sistema Case (A40-155494/2014) is a good example of such a lawsuit]. However, one should note that such actions are very rare, and the question whether the prosecutor is bound by an arbitration clause arises even more rarely.

Surprisingly, Russian courts take a view that a prosecutor is bound by an arbitration clause included in a contract. In particular, on 31 January 2003, the Prosecutor of the Kaliningrad Region filed an action with the Arbitrazh Court of the Kaliningrad Region (court of first instance) seeking a declaration that a loan agreement entered into force in 1997 between Kaliningrad Region and Dresdner Bank AG was void (case A21-2499/2003). The court rejected the case because the loan agreement contained an arbitration clause.

The Prosecutor appealed the first instance ruling, alleging that the Prosecutor, acting in public interest, was not bound by the arbitration clause, and could challenge the loan agreement in the Russian courts. However, the Thirteenth Arbitrazh Court of Appeal (court of appeal), in its decision dated 23 June 2005, upheld the first instance ruling referring the parties to arbitration. In 2006, the Supreme Arbitrazh Court of Russia declined to re-examine the case (The Supreme Arbitrazh Court's opinion has never been published).

Finally, in the case A65-5171/2006, the Arbitrazh court of the Tatarstan Region (court of first instance) also refused to hear a prosecutor's application, and referred the parties to arbitration. The decision has never been appealed.

### **Conclusion**

The negative effect of derivative proceedings on the recognition and enforcement of arbitral awards in Russia has been criticized by Russian scholars. Moreover, the Russian Arbitration Association suggested amendments on arbitration law in order to prevent such shareholders' conduct. However, the Russian legislative body did not and does not give any attention to the suggested amendments.

Although a winning party may enforce an arbitral award against a Russian company elsewhere under the New York Convention 1958, this possibility is weak if a Russian company (a losing party) has no suitable assets abroad.

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