Creeping “Crusade” of Russian Courts against Arbitrability of Public-Related Disputes

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Wide interpretation of a non-arbitrability exception may frustrate the purpose of promoting international commercial arbitration. So far, Russian courts have not been able to formulate a clear cut and consistent rule on the arbitrability of disputes with a public element, in particular disputes arising from agreements concluded under public procurement schemes.

Russian law as it stands today does not provide an exhaustive list of disputes considered non-arbitrable. This leads to legal uncertainties when it comes to the choice of dispute resolution mechanisms. At different times, courts ruled that controversies arising out of agreements for the lease of land plots (case No. A26-9592/2012) and corporate relations (case No. A40-35844/11) were reserved for state courts.

In 2014 the Supreme Commercial Court held that parties to a contract concluded pursuant to a public procurement scheme could not agree on alternative dispute resolution. This was the first time when arguments of public interests, the need for transparency and openness, and the principle of economy of budgetary funds were used to justify the restrictive approach to the arbitrability of procurement-related disputes. However, the idea of a public element in the context of arbitration is not new in Russia, and it can be traced to the initial position of Russian courts regarding real estate disputes, which were considered non-arbitrable until the interference of the Constitutional Court in 2011.

Non-arbitrability of public procurement disputes

In the abovementioned case of 2014 (case No. A40-148581/12), the dispute arose from the agreement between a public establishment of the Moscow Health Department and privately held ArbatStroy LLC (MHD v. ArbatStroy). The agreement concerned construction works in hospitals and was concluded through a public tender under the Federal Act No. 94-FZ “On Placing of Orders for the Delivery of Goods, Works and Services for the State and Municipal Needs”, dated July 21, 2005 (Federal Act No. 94-FZ), which regulates bidding by state, municipal authorities, and public establishments. The arbitration clause contained in the agreement allowed an arbitral tribunal to render its award. However, the Supreme Commercial Court refused to recognize it, arguing that public interest in the proper performance of the agreement effectively deprived it of its civil (private) nature. Besides, the considerations of the efficiency of public spending and prevention of corruption spoke in favor of state litigation, rather than arbitration, notable for its principles of confidentiality, flexibility, and finality.

The non-arbitrability of disputes stemming from agreements entered into under the Federal Act No. 94-FZ was inherited and accepted by the Supreme Court in 2015 (case No. A41-60951/13). The case related to the execution of a municipal contract between the city of Dubna (Moscow region) and a private contractor. The court reiterated argumentation from MHD v. ArbatStroy, holding that public interest in monitoring the legality, expediency, reasonableness, and effectiveness of government expenditures mandated a special approach to public procurement disputes.

Public element does not always make a dispute non-arbitrable

Although disputes related to the provision of services for state and municipal needs are reserved for state court litigation, the situation involving companies owned by the state and their contracting parties remain unclear. On one hand, such entities are separated from the government by a corporate veil. On the other, they may in fact perform important functions for the general interest and receive public money. The question remains whether a public element present in the activity of state owned enterprises dictates the same narrow approach to arbitrability as noted above. In this regard, it should be concluded that there is no uniformity in the case law.

In February 2015, the Supreme Court judge refused to refer a case to the panel, validating findings of the lower courts. The case concerned a dispute between a JSC Federal Grid Company, ultimately owned by the state, and a privately held company (case No. A56-25135/2015). The dispute emerged from undue performance by the latter of its obligations under the works agreement concluded through a bidding process pursuant to the Federal Act No. 223-FZ "On Procurement of Goods, Works and Services by Certain Legal Entities", dated July 18, 2011 (Federal Act No. 223-FZ). This Act applies to tendering by state corporations, companies with state participation, natural monopolies, and entities performing regulated activities, e.g., the provision of electricity, gas, heating, and water. The Supreme Court noted that there were no grounds to extend its stringent approach applicable to the Federal Act No. 94-FZ to matters falling under the Federal Act 223-FZ, and it authorized the enforcement of an arbitral award.

One year later, in February 2016, another Supreme Court judge came to a different conclusion based on the analysis of the same law. It affirmed the refusal to recognize an award rendered in a dispute between Kazan Federal University and Fifth Element LLC (case No. A72-5089/2015), emphasizing that the principle of publicity and the need for public control over bidding process equally applied to tendering under both the Federal Act No. 94-FZ and No. 223-FZ. This is despite the fact that neither of the two laws expressly exclude arbitration of procurement disputes, and that a year ago the same court took a different view. In any case, a dire conclusion made in this recent judgment can have far reaching destabilizing implications, taking into account wide application of the Federal Act No. 223-FZ and the fact that the overall share taken by the state in the economy exceeds 70 % of GDP.

Conclusion

There might be a compelling public interest in controlling certain transactions, especially those entered into by state and municipal bodies. The confidentiality of proceedings and procedural flexibility in arbitration may present an obstacle to such control. At the same time, considerations of party autonomy, efficiency, special expertise, and foreseeability strongly advocate in favor of arbitration. Non-arbitrability exception should be narrowly tailored to achieve clearly articulated goals, so that the exception does not become a rule.

When does a public element suffice to make an otherwise arbitrable dispute non-arbitrable is a million-dollar question, which seems to have confused even the judges of the Supreme Court. The recently adopted arbitration laws in Russia that will come into force in September 2016 articulate that disputes arising out of procurement for state and municipal needs cannot be submitted to arbitration.

The law is silent on whether other public-related disputes (e.g., disputes with state owned enterprises) will be open to arbitration. This means that uncertainty around arbitrability of disputes with a public element will most probably persist, and parties to such transactions should be aware of the respective risks.