In Arbitration We Trust: What Are the Lessons from the Trust v Fosint Ltd case (Russia)?

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The Russian Supreme Court recently rendered a decision declaring disputes on challenging agreements with banks in a special financial situation, called by lawyers – "troubled" banks, as non-arbitrable [Bank Trust v. Fosint Ltd., decision dated 16 August 2016 number 305-ЭС16-4051] ("Trust case").

In this case, a "troubled" bank, meaning a bank in which a temporary administration was appointed by the Central Bank and the procedure of sanation was initiated, filed a claim challenging its agreement regarding the purchase of promissory notes. The courts of three different instances referred the claimant to arbitration due to the presence of an arbitration clause in the agreement. The Supreme Court reversed all judgments and sent the case back to the court of the first instance.

The facts of the case

The Central Bank of Russian Federation has authority to nominate a temporary management in so-called "troubled" banks in order to improve their financial situation. This procedure is called sanation. The Agency of Insurance of Deposits (AID) acts as a temporary management, and is financed from the state budget. Different powers of such management, including the right to challenge the transactions of the bank, are stipulated in the Bankruptcy Law.

In 2014, the Central Bank nominated a temporary management in Bank Trust. During their service, the officials of the AID discovered in the bank's CEO's safe the agreement on the purchase of promissory notes from Fosint Ltd., in the amount of more than 70 million USD. The agreement contained an arbitration clause referring all disputes to the ICAC (Moscow). The AID assumed that this agreement might be falsified and that the transaction was void because it was done in the violation of internal banking rules, and it was also not mentioned in accounting documents. Moreover, the AID believed that this transaction violated the rights of other creditors because it stipulated an obligation of the bank to purchase expensive promissory notes instead of making payments to the customers of the bank.

Despite the arbitration clause, the claim on challenging the agreement was filed with the state court. State courts of three different instances referred the claimant to arbitration based on the insertion of the arbitration clause in the contract. They pointed out that state courts have exclusive jurisdiction over bankruptcy cases while this claim was not a bankruptcy claim. The courts concluded that the

case was not a bankruptcy case because the powers of a temporary management were terminated a few days before the filing of the claim, and that the claim was filed by the bank itself rather than by the temporary management. In addition, the courts pointed out that the grounds for the challenge combined both bankruptcy grounds and general grounds for challenging transactions. Therefore, this claim did not fall into a category of cases of the exclusive jurisdiction of state courts.

The Supreme Court did not agree with this reasoning.

It interpreted the law in a way that sanation was one of the stages of bankruptcy, and it did not end when the powers of temporary administration were over, but continued until the plan of recovery and restructuring of the bank would be fulfilled.

In addition, the Supreme Court stated that under current law only private disputes subject to some limitations are arbitrable, while disputes arising out of public relations can not be transferred to arbitration. With relation to the bank, a special procedure of preventing bankruptcy – sanation – conducted by the AID, in accordance with the special law and further acts of the Central Bank, was initiated. Such procedure also introduced public interference into private relations in a credit sphere. The aim of such interference is to defend the rights of the customers of the bank – the owners of deposits. By financing a special agency in charge of preventing bankruptcy of the credit organization, the state is conducting an action having a public character, and economic and social goals. Therefore, current dispute on challenging the validity of the transaction is a dispute with public character, and as such could not be referred to arbitration.

Comment

Even though Russia is not a common law country, the rulings of the highest courts has always been known for attracting a lot of attention of Russian lawyers. This is especially important after the merger of two highest courts – the Supreme Commercial Court and the Supreme Court.

Before this merger took place in August 2014, most of arbitration related issues, which were referred to state courts, were handled by the Supreme Commercial Court. The Supreme Commercial Court, in general, adopted a pro-arbitration approach. It issued different guidelines, including informational letter number 156 as of 26 February 2013 which significantly decreased the scope of public policy and the possibility of refusal of the enforcement of arbitral awards based on this ground.

After the merger, lawyers wondered whether the course of favoring arbitration would continue or not. As a good sign for arbitration, in 2015, the Supreme Court enforced two Ukranian arbitral awards by reversing unfavorable judgments of the lower courts.

The Supreme Court has discretion whether to hear claims brought before it or not. Less than one percent of such claims is heard by the Supreme Court. Therefore, each case related to arbitration which the Supreme Court decides to hear, and the *Trust case* is one of such examples, attracts a lot of the attention of arbitration practitioners.

The arbitrability of disputes involving bankrupt companies differs from jurisdiction to jurisdiction. In some countries, after the commencement of bankruptcy proceedings, continuance of the arbitration is impossible without the permission of the court (England, Hong Kong), or a bankruptcy administrator is entitled, with the permission of the court, to deny the enforcement of an arbitration agreement (Poland, Singapore). Quite the opposite, in some other jurisdictions, an arbitration agreement continues to be valid (Germany, France, Switzerland, Sweden). Furthermore, it is sometimes considered that an arbitration agreement does not cover disputes regarding the validity of a contract containing arbitration clause, if the claim is filed by an administrator acting not in his/her capacity as

a debtor's representative, but as a representative of the creditors (Germany, France, Switzerland). This information with more details and reference to particular cases was presented by the Arbitration Association (RAA) in Amicus Curiae filed to the Supreme Court. This was the first *Amicus Curiae* submitted to the Supreme Court after the merger (Text of *Amicus Curiae* in Russian can be found here.)

Russian law contains only a short rule that "bankruptcy cases can not be transferred to arbitration". In that regard, an important lesson from the *Trust case* is that sanation of a "troubled" bank is an integral part of bankruptcy proceedings, and it continues to be such even when the powers of a temporary administration are terminated. Therefore, the transactions of the "troubled" bank can be challenged only in a state court.

A less clear lesson is regarding the definition of a public character of a dispute based on the reasoning of the Supreme Court: whether such definition can be extended to *all* disputes involving "troubled" banks financed by the state, and courts would render all those disputes also non-arbitrable.

On the one hand, the Supreme Court pointed out that sanation financed by the state is a state activity of a public character. The conservative approach in such a situation is to treat any dispute involving banks under sanation as non-arbitrable.

On the other hand, the Supreme Court analyzed and interpreted the law in relation to a particular claim. An argument about "public character" of the dispute was one of several arguments. I believe that in this particular case and in these particular circumstances the underlying reason for using a definition of "public character" by the court was the protection of the rights of the parties which are less powerful in the case of financial failure of the bank, i.e. the customers of the bank, and to provide the bank with a possibility to challenge suspicious transaction in a state court.

From that point of view, disputes which positively influence the financial situation of a bank as, for example, monetary claims against the debtors of the bank, may not always need a special treatment and protection.

The plan of sanation can be realized during the period of 5 to 10 years. Referring to the state courts all disputes, including disputes arising out of ordinary transactions and claims of the bank against its debtors, can be considered to be a too strict interpretation of the law at issue.

The Supreme Court's decisions on a particular case are not obligatory for the courts of the lower instances, though these courts usually take them into account. The approaches of the courts may differ from region to region. In the present situation, the courts of lower instances may stick to a broader application of the "public character" rule in order to avoid risk of reversals of their judgments.

However, we can only wait and see what impact the decision in the *Trust case* will have on further practice.

The views and opinions expressed in this post are those of the author, and do not reflect the opinions of the KIAP, the Arbitration Association (RAA), or the members of the working group of the RAA.