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Does Noncompliance with Pre-arbitration Dispute Settlement Procedures Affect Awards Enforceability in Russia?

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Dispute resolution clauses often provide for negotiations, conciliation or a similar procedure before arbitration. Both UNCITRAL Model Law on International Commercial Arbitration and the Russian law contain no provisions on the legal effect of the pre-arbitration procedure of dispute settlement. In particular, they are silent on whether its non-fulfillment precludes the arbitral tribunal's competence. Accordingly, state courts have to determine whether and where a failure to comply with such procedure forms grounds for refusal to enforce an arbitral award.

Sometimes in cases on foreign or domestic arbitral awards' enforcement, or on setting aside domestic awards, debtors argue that the case was heard on the merits and the award was rendered by the arbitral tribunal despite the claimant's non-compliance with the mandatory pre-arbitration procedure of dispute resolution agreed upon by the parties. As it is clear from the examples given below, Russian courts acted on the assumption that the issue of the parties' compliance with the pre-arbitration procedure falls within the competence of arbitrators.

This issue was firstly considered by Russian courts in 2002. The Arbitration court at the Geneva Chamber of Commerce and Industry on April 6, 2000 obliged the Russian CJSC Neftekhimeksport to pay to the Swiss Cargill International S.A. over US$17 mln., including the indebtedness under the purchase agreement, penalty, interest and arbitration costs. The debtor did not execute this award voluntarily, and the creditor applied before the Moscow city Court to enforce the award (at that period the courts of general jurisdiction were competent to deal with such applications). The agreement provided that, should the parties fail to come to a mutually acceptable solution, the dispute shall be referred to a mediator to be appointed by the Geneva Chamber of Commerce and Industry. If such mediation does not result in a written settlement of the dispute within two months since the appointment of the mediator, any such dispute shall be finally resolved in accordance with the Arbitration Rules of the Chamber of Commerce and Industry of Geneva. The debtor declared that the creditor had not abided with the mediation clause. In the debtor's opinion, the award as rendered could not be enforced under Article V(1)(c) New York Convention in respect of the dispute that is not covered by the arbitration clause.

The court rejected this argument and granted the award's enforcement (case No. 5-?02-23). The Supreme Court upheld the ruling and said that the pre-arbitration dispute settlement provisions do not form part of the arbitration agreement.

In 2005 a case of claimant's failure to comply with the pre-arbitration procedure was heard by the

Moscow Commercial Court which reached the same conclusion; however it took into account another significant aspect, this time of a procedural nature. The ad hoc arbitral tribunal in Stockholm, acting in accordance with the UNCITRAL Arbitration Rules, heard the dispute and rendered an award on recovery against OJSC Moscow Oil Refinery in favor of the Joy-Lad Distributors International Inc. (USA) of a penalty exceeding US$28 mln., interest and arbitration costs.

The contract provided: “The Parties shall take all necessary measures to settle any disputes, disagreements or claims which may arise out of or in connection with the present agreement, by mutual consultations. Should the Parties fail to reach an agreement on the said issues, then, with the exception of submission to courts of general jurisdiction, they shall be heard in the arbitration court of the city of Stockholm (Sweden) in accordance with the UNCITRAL Arbitration Rules (1976)”. The Stockholm Chamber of Commerce was specified as the competent body.

The court granted the enforcement and held: “In compliance with Article 30 of the UNCITRAL Arbitration Rules (1976), a party who knows that any provision of, or requirement under, these Rules has not been complied with and yet proceeds with the arbitration without promptly stating his objection to such non-compliance, shall be deemed to have waived his right to object”. The court found out that the defendant did not raise such objection in arbitration and thus have waived his right to object (case No. ?40-64205/05-30-394). The higher court upheld the ruling.

In this case the non-compliance with the pre-arbitration procedure would have been impossible to prove anyway as its wording is too vague. Yet it is noteworthy that, unlike the Supreme Court in the aforementioned case, the Moscow Commercial Court found it necessary to determine whether the defendant had objected to non-compliance with the pre-arbitration procedure in the course of the arbitration proceeding.

Article 4 of the Law on International Commercial Arbitration is analogous to Article 30 of the UNCITRAL Arbitration Rules. Therefore, irrespective of the applicable arbitration rules, the defendant who failed to refer to the pre-arbitration procedure in the course of the arbitration proceeding, shall be considered to have forfeited the right to make such reference in future. Such approach appears reasonable.

In 2007 the Russian commercial courts addressed the issue of whether the failure by a claimant to comply with the pre-arbitration procedure might constitute a ground for the arbitral award’s cancellation. The International Commercial Arbitration Court at the Chamber of Commerce and Industry of the Russian Federation (“the ICAC”) in 2006 issued an award (case No. 26/2006) on recovery from LLC Dunapak-Ukraine in favor of the Russian OJSC Oskoltsement of an amount about 2,300,000.00 roubles plus arbitration costs. The debtor applied to the Moscow Commercial Court to set aside the award.

The agreement between the parties stipulated that, if the parties fail to settle the disputes within 30 days since the start of the negotiations, such dispute shall be referred to the ICAC. The debtor argued that the parties had entered into a supplement agreement, and that the award creditor had not filed any demands in respect of performance of its terms and conditions but had filed a claim directly to arbitrate. In the debtor’s opinion, it proved that the pre-arbitration procedure was not adhered to, and that the dispute did not fall within the arbitration agreement, and hence the award was to be set aside. Nevertheless, the courts of first and cassation tiers in 2007 (case No. ?40-15779/07-40-156) dismissed this argument stating that the issues of performance by the parties

of the contractual obligations are irrelevant for the arbitral tribunal competence issue.

In case No. 18/2007 OJSC Gazprom v. Moldovan-Russian JSC Moldovagaz on recovery of payment for supply of goods, the ICAC found that the claimant failed to comply with the contractual pre-arbitration procedure of dispute settlement and terminated the proceedings. Though the Moscow Commercial Court dismissed the award on formal grounds, it did not question the termination of the proceedings. The court referred to Art. 19(2) of the Law on International Commercial Arbitration and held that, in the absence of an agreement between the parties on the procedure for initiation of the proceeding, the tribunal had conducted the arbitration in the manner as it considered appropriate. The ruling was upheld by the higher court (case No. ?40-27465/08-50-207).

Thus in the said cases, the courts, having based their decisions on different rationale, concluded that the issue of compliance with the pre-arbitration procedure falls within the exclusive competence of the arbitral tribunal.

In my opinion, the parties' compliance with the pre-arbitration procedure should be explored by the arbitral tribunal when deciding on its competence. It has nothing to do with Art. V(1)(c) of the New York Convention. If the arbitral tribunal hears the case despite an evident violation by the claimant of an explicit pre-arbitration procedure agreed upon by the parties, and the defendant expressly refers to such violation in course of the arbitral proceeding, the arbitral procedure is not in accordance with the agreement of the parties (Art. V(1)(d) of the New York Convention). Under Art. 21 of the Law on International Commercial Arbitration, unless otherwise agreed by the parties, the arbitral proceedings in respect of a particular dispute commence on the date on which a request for that dispute to be referred to arbitration is received by the respondent. The parties' arrangement on the arbitration proceeding starting only upon completion of the agreed pre-arbitration procedure may well be considered as "other" agreement. The compliance with the pre-arbitration provision is a condition precedent for hearing the case on the merits.

For example, let's assume that the parties stipulated in the agreement that, should a dispute arise, one party shall send to the other party a written demand, and that the arbitral tribunal shall not be entitled to hear the case until such demand is sent and a fixed period for reply expired. Should the claimant fail to send the demand and to wait, and the arbitral tribunal ignored such violation notwithstanding the respondent's objection, the court may refuse to enforce the award because the arbitration process did not conform to the parties' agreement. However, much depends on the wording of the dispute resolution provisions and the specific facts of the case.

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