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Russian Laws on the Offensive: Cross-Border Effect of the New Arbitration Regime for Corporate Disputes

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Russia has recently revised its arbitration laws. The key development of the reform is to address the arbitrability of so-called "corporate disputes." The new laws lift the longstanding ban on arbitrating most types of controversies relating to a Russian company. There is a catch, though: the lawmakers set out mandatory procedural conditions with which any arbitration of corporate disputes must comply ("Conditions").

The Conditions vary depending on the type of corporate dispute. If the subject matter of the dispute is about shares in a Russian company – e.g., a pure M&A transaction – the only condition is that parties use institutional arbitration. (To distinguish from *ad hoc* arbitration, Russian laws use a term of art "permanent arbitral institution" which means the same as "arbitral institution" in other jurisdictions.) If, however, a dispute is about an internal corporate matter – e.g., a shareholders' agreement – the list of requirements expands:

• the seat of arbitration must be Russia;
• all shareholders and the Russian company itself must sign the arbitration agreement;
• an arbitral institution must administer the proceedings (and it must have a license to administer arbitrations seated in Russia); and
• the institution must have special arbitration rules for corporate disputes (and deposit them with Russia's Ministry of Justice).

While the Conditions may look straightforward, it is not yet clear how they will operate in the context of international arbitration and cross-border proceedings. One can expect a lot of debate on whether the Conditions have extraterritorial application and how they fit with Russia's international treaties. In this entry, I summarize the queries that international arbitration users may have and give a high-level analysis of these issues.

1. What is the procedural nature of the Conditions?

Normally, a mandatory rule governing a certain aspect of arbitral procedure – such as seat, form of arbitration agreement, use of institutional or *ad hoc* arbitration – is deemed to be part of the *lex arbitri*, the procedural law of the seat of arbitration. If the arbitration does not comply with such a rule, the resulting award may be attacked on the grounds that the arbitration agreement was invalid or that the arbitral procedure breached the *lex arbitri*.

However, Russian lawmakers did not just introduce the Conditions into the Arbitration Act as mandatory procedural rules. They went further and, firstly, added the Conditions to the Arbitrazh Procedure Code ("APC") that governs arbitrability in Russia and, secondly, phrased them as prerequisites to arbitrability of corporate disputes (rather than as mandatory rules applicable to adjudication of corporate disputes in arbitration). The Conditions therefore form part of "conditional arbitrability" – a concept new to Russian law, under which a subject matter cannot be submitted to arbitration at all unless certain conditions are met.

2. Are the Conditions supposed to apply to arbitral proceedings seated outside Russia?

If the Conditions were just mandatory rules of Russia's *lex arbitri*, they would apply only to arbitrations seated in Russia and be irrelevant to proceedings seated in other jurisdictions. Russian lawmakers, however, chose to "upgrade" the Conditions' status to the level of arbitrability.

By doing so, they gave the Conditions an extraterritorial boost. When a country considers a particular subject matter non-arbitrable, it can refuse to enforce an arbitration agreement or award under the New York Convention irrespective of where the arbitration is based. Apparently, the legislative purpose was to make the Conditions applicable to any arbitral proceedings in the world relating to a Russian company – even if none of the parties is Russian and the case's sole nexus with Russia is that the subject matter of the dispute is incorporated there.

Consequently, at least from the perspective of Russian law, the Conditions appear to have a cross-border effect. In other words, parties are expected to use institutional arbitration to resolve a dispute regarding Russian shares even if the proceedings take place outside Russia.

3. Does the cross-border effect of the Conditions contradict Russia's obligations under international treaties?

Arguably, the Conditions are not compatible with Russia's obligations under the New York Convention ("NYC"), the European Arbitration Convention and the CIS Agreement on Settlement of Disputes related to the Commercial Activity ("Kiev Agreement"). It is, however, questionable if Russian courts will refuse to apply the Conditions to international arbitration proceedings due to these treaties.

New York Convention. In theory, the novel concept of "conditional arbitrability" circumvents the choice-of-law principles embodied in the NYC. Under the NYC, a court seized with enforcement of a foreign award shall not assess validity of an arbitration agreement (Article V(1)(a)) or breaches of arbitral procedure (Article V(1)(d)) under its local standards – it should apply the law governing the arbitration agreement or the *lex arbitri* instead. When a jurisdiction chooses to tie arbitrability of disputes (Article V(2)(a)) to compliance with its own laws, it creates a "backdoor" for applying the same local standards to foreign proceedings, albeit under a new label of "arbitrability."

In practice, several countries besides Russia have already adopted the concept of "conditional arbitrability" in the context of domestic arbitration: for example, the US – in disputes out of motor vehicle franchise contracts; Belgium – in disputes over termination of distributorship or agency; Germany – for claims to annul corporate resolutions. While it is early to state if there is an international trend towards allowing "conditional arbitrability," Russian courts might follow these examples and conclude that the Conditions are compatible with the NYC.

European Arbitration Convention. This Convention applies to arbitration agreements between parties domiciled in its signatory states (Article I(1)). It should apply, for instance, to corporate disputes between Russian and German shareholders. Among other provisions, the Convention guarantees parties the freedom to choose between institutional and *ad hoc* proceedings and to select the seat of arbitration (Article IV(1)).

Technically, the Conditions contradict Russia's obligations under this treaty, because they restrict the freedom of the parties to choose *ad hoc* over institutional arbitration or to move the seat outside Russia. It is, however, uncertain if Russian courts will agree that the European Arbitration Convention preempts the Conditions – they often ignored it in the past.

Kiev Agreement. Under this treaty, parties domiciled in CIS countries are free to agree to submit commercial disputes to competent courts of any CIS country (Article 4(2)). The definition of "competent courts" includes arbitral tribunals (Article 3). The signatory states retain exclusive jurisdiction over only real estate disputes and claims against public authorities (Article 4(3)-(4)). Further, the Kiev Agreement does not enlist non-arbitrability or public policy as valid challenges against enforcing a competent court's decision (Article 9).

In theory, therefore, the Conditions should not apply to arbitrations between CIS parties and seated in a CIS country. However, Russia's Supreme Court has ruled (controversially) in *Case No. 310-ES-4266* that the Kiev Agreement does not apply to international commercial arbitration, despite Article 3's definition of "competent courts." Consequently, a challenge to the Conditions based on the Kiev Agreement is currently unlikely.

4. What if parties disregard the Conditions and have a seat of arbitration outside Russia?

Notwithstanding the extraterritorial effect of the Conditions, parties can ignore them and arbitrate corporate disputes in a foreign jurisdiction pursuant to a foreign law.

Most authorities refuse to apply foreign arbitrability rules. Arbitral tribunals generally rule on arbitrability according to the *lex arbitri*, and courts apply their own local law. Thus, from the perspective of non-Russian law, the Conditions, being just rules of a foreign jurisdiction, do not affect enforceability of arbitration agreements or awards outside Russia.

5. How will Russian courts treat non-compliant arbitration agreements and awards?

It appears obvious that Russian courts will refuse to enforce arbitration agreements that do not comply with the Conditions if they provide, for example, that internal corporate disputes be seated outside Russia. The Russian law does not draw any important distinction between non-enforcement grounds, but finding a non-compliant agreement "incapable of being performed" seems the most appropriate ground (see Articles 48(7)-(8) & 52(16) of the Arbitration Act). More importantly, such an agreement will not have a negative effect in Russian judicial proceedings; a party may then face a risk of having to litigate the same dispute in Russian courts.

A foreign award rendered in an arbitration that did not comply with the Conditions will also be unenforceable in Russia. Most probably, the courts will use the "non-arbitrability" exception (NYC Article V(2)(a)). However, the courts may also refer to the "public policy" exception (Article V(2)(b)), for example, if the court finds that the Conditions aim to protect the interests of shareholders in Russian companies and the protection of shareholders' interests constitutes a fundamental principle of Russian law.

6. In light of the Conditions, can parties submit disputes involving shares in Russian companies to foreign arbitral institutions that are not licensed in Russia?

The intended cross-border effect of the Conditions may confuse Russian courts when they deal with corporate disputes that only involve shares in a Russian company. As mentioned above, the APC requires that parties resolve such disputes in a "permanent arbitral institution" (a Russian term of art for an "arbitral institution").

This Article does not specify which law determines what a "permanent arbitral institution" is. Russian courts might therefore be tempted to decide this issue under Russia's Arbitration Act. Article 44(3) of this Act states that "foreign arbitral institutions are recognized as permanent arbitral institutions provided they obtain a license . . . in accordance with this Article." A Russian court may then conclude that a foreign institution cannot consider a dispute about shares in a Russian company unless it obtains a license in Russia.

This approach is incorrect, because it gives extraterritorial effect to the Arbitration Act which it does not have. Article 1 of the Arbitration Act expressly limits its scope to arbitrations seated in Russia and does not expand it to international arbitrations seated outside Russia. Accordingly, Russia's government is supposed to license only those institutions that want to administer Russia-seated arbitrations. The text of Article 44(3) confirms this as well: this provision contains a sanction for non-compliance, and it is limited only to "awards rendered . . . in the territory of Russia."

It is more appropriate to determine whether a foreign arbitration was institutional as a factual issue. The text of the arbitration agreement, the applicable arbitration rules, or sometimes the *lex arbitri* can answer whether the parties agreed to arbitrate in a "permanent arbitral institution." Consequently, if read properly, Russian law does not require foreign arbitral institutions to have a Russian license to administer foreign-seated arbitrations about shares in Russian companies.

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