Kluwer Arbitration Blog

Russian Supreme Court's Stance Shakes Up Enforcement of Foreign Arbitral Awards

Rostislav Kats (Kluwer Law International) and Anastasiya Ryabova (KIAP) · Sunday, August 25th, 2024

On 26 July 2024, the Russian Supreme Court issued a landmark ruling (the "Ruling") outlining a novel stance on the recognition and enforcement of foreign arbitral awards. This jurisprudential shift, which is decidedly not pro-arbitration, erects new barriers for persons domiciled in countries deemed "hostile" or "unfriendly" by Russia to obtain their consideration in the disputes.

Background

The Case at Hand

In 2020, C. Thywissen GmbH (Germany) ("Thywissen") entered into an agreement with JSC Novosibirskhlebprodukt (Russia) ("NHP") to purchase flaxseed ("the Agreement"). The Agreement set up London-seated arbitration of any disputes under the FOSFA Arbitration Rules ("the Rules").

NHP failed to perform its obligations on time and proposed to extend the delivery dates due to force majeure. Thywissen rejected that proposal and triggered the arbitration clause. On 16 November 2022, the tribunal rendered the arbitral award ("the Award") obliging NHP to compensate Thywissen damages, interest, and arbitration costs, including legal costs.

Thywissen applied for recognition and enforcement of the Award with the Arbitrazh (Commercial) Court of Novosibirsk Region (the first instance court). The first instance court granted the application stating that the award did not contravene Russian public policy.

Then, NHP applied to challenge the lower court's ruling to the Arbitrazh Court of the Western Siberian Circuit (the cassation court) arguing that it had not been properly notified of the proceedings and that enforcement of the Award would be contrary to public policy of Russia because of the arbitrators' lack of independence and the excessive damages awarded.

The cassation court upheld the ruling and declined all of NHP's arguments. It is highlighted that NHP's behaviour in the course of arbitration proved that it had been aware of the proceedings and actively engaged in them. As to NHP's arguments regarding the excessive nature of the awarded damages, the court stated that the damages were not pecuniary and did not establish a public order

violation.

NHP proceeded to apply to the Supreme Court ("the Court"), asking the court to quash the lower courts' decisions. On 27 May 2024, the Supreme Court judge rendered a ruling confirming that the application would be considered by the Economic Panel.

The Lugovoy Law and Further Restrictions

The legal background for transferring the case to the Supreme Court has been developing for a while. Having continuously monitored arbitration-related case law in Russia, the authors noted that since February 2022, the applications for recognition and enforcement of "Western" arbitral awards in Russia have been generally limited.

In a notable August 2022 ruling, the Moscow Circuit Arbitrazh Court resisted enforcing an LCIA award against a strategic Russian entity, citing potential impacts on the national budget. A similar approach as detailed below, was adopted by the Supreme Court

The Supreme Court's perspective has also been shaped by the application of Articles 248.1 and 248.2 of the Russian Arbitrazh Procedure Court (the "Lugovoy Law"), which assert exclusive jurisdiction over cases with sanctioned entities and allow injunctions against foreign arbitration or litigation. The *Uraltransmash v. Pesa* case, previously discussed here, set a precedent: the mere presence of personal sanctions triggers the Lugovoy Law, without requiring proof of actual barriers to justice abroad.

Russian courts have since adopted an expansive interpretation of the Lugovoy Law, often applying it in the absence of personal sanctions. Judges frequently cite the location of an arbitral institution or court in the "unfriendly" states as a key factor, diverging from the law's text and legislative intent. This trend is concerning and widespread.

Analysis

Despite the brevity of the Ruling, the Supreme Court's analysis is profound, yielding several critical conclusions.

The key and undoubtedly unexpected issue of this Ruling was that the Supreme Court presumed the lack of impartiality and objectivity based on the arbitrators' nationality (in this case, Ukraine, the UK, and Denmark) of an "unfriendly" state absent evidence to the contrary. The Court did not pay attention to the personality of the arbitrators, their connections with the parties, governments or anyone else, or their opinions expressed in public or on paper. A positive implication of the Court's analysis is that the presumption created by the Court is rebuttable. However, the criteria required to rebut this presumption are unclear and were not discussed by the Court.

When discussing the meaning of independence and impartiality, the Court echoed its own reasoning in *Uraltransmash v. Pesa* case and referred to the ECtHR's practice which emphasised the importance of a judge's impartiality (established in *Kyprianou v. Cyprus* and *Revtyuk v. Russia*), although this practice has little bearing on the Court's conclusions in the Ruling.

This Supreme Court's stance also contrasts with the prior jurisprudence of the Constitutional Court which established that an arbitrator's impartiality cannot be solely inferred from objective factors, such as their nationality.

NHP's contention that an arbitrator lacked independence due to shared FOSFA committee membership with Thywissen's representative, and procedural irregularities in the arbitrator's appointment, was deemed insufficiently examined by the lower courts. This approach also contradicts the previous practice of the Russian courts cited above.

In addition, the Supreme Court underscored the proportionality of civil liability as a cornerstone of Russian public policy. The Court found that Thywissen had not demonstrated in the arbitration that it had suffered any loss or had entered into a substitute transaction, alongside that it had not taken any measures to mitigate the potential loss and had refused NHP's offer to extend the delivery period, and, thus, the courts failed to consider observation of the principle of proportionality of civil liability.

The Court criticised the arbitrators for dismissing the NHP's force majeure defense without proper examination of the regional state of emergency due to adverse climatic conditions (drought) that took place in Novosibirsk region (place of NHP's origin) during the relevant period. According to the Court, the lower courts should have examined the local authorities' decree introducing the said regime.

The Supreme Court found that the lower courts had failed to assess the consequences of enforcement of the arbitral award in Russia and to consider the public profile of the Russian company. The potential impact of enforcement of the award on the financial and social stability of the region was considered to be significant, following a 2022 precedent set by the Arbitrazh Court of the Moscow District in its decision in case No. A40-142624/2021 discussed above.

The Supreme Court also found that the lower courts had not adequately considered NHP's arguments regarding the lack of clarity in the arbitration appeal process and the challenges posed by sanctions, such as non-receipt of the award, and argued the inability to obtain legal assistance in the UK.

It is also worth noting that the Supreme Court overturned the decisions of the previous courts but did not render the final decision in the analysed case. The first instance court has yet to review the case, but regardless of the outcome, the Supreme Court's decision will certainly have an impact on other cases.

Implications of the Ruling

The Supreme Court has given a second wind to the application of the public policy exception with perhaps one of the broadest interpretations in the history of Russian jurisprudence. The Supreme Court's expansive interpretation of public policy requires strategic foresight. Below are some of the implications of the Ruling that can be considered, as well as some thoughts on how the Court's conclusions may be interpreted in the future.

As noted above, the Court did not establish any criteria or grounds for rebutting the presumption of lack of independence of arbitrators from "unfriendly" countries. Based on the experience of

working with Russian courts, the authors suggest that interested parties should, if possible, avoid appointing such arbitrators.

If this is not possible, it is necessary, when appointing arbitrators, to investigate their background, the institutions on which the candidates are listed, the statements they have made publicly or privately and their nationality. It is useful to gather this information and submit it to the court before the issue is raised in the state court proceedings.

If the arbitration proceedings have already commenced, it is advisable to keep (highly) ethical conduct and compliance with soft and hard legal norms during the arbitral proceedings. It is also advisable to maintain meticulous records of proceedings and evidence to counter any claims of procedural impropriety or lack of due process. This volume of documents may be helpful in convincing the court that the arbitrators were in fact independent and impartial, as evidenced by their conduct.

If the nationality of the arbitrator is already a concern for the Court, the choice of an arbitral institution located in an "unfriendly" state (such as the ICC or SCC), especially in combination with the respective seat and *lex arbitri*, would also create many hurdles before, and even if, an award is enforced in Russia. It also increases the likelihood that a Russian company will bring its claims before a Russian state court in disregard of an arbitration agreement.

The Supreme Court's conflation of public policy with Russian law itself, as well as its extremely broad interpretation, may discourage foreign companies from engaging with Russian counterparts, signaling a red flag in due diligence processes.

Given the evolving practice, if a tribunal is composed of arbitrators of what the Supreme Court considers to be a "non-impartial" nationality, the public policy exception may, in principle, be invoked against any arbitral award. These implications may extend beyond "unfriendly" states and awards made under the rules of "unfriendly" institutions, potentially affecting various international actors, for example from Turkey and China.

Conclusion

In conclusion, this ruling by the Russian Supreme Court signals a stringent approach to the enforcement of arbitral awards, with far-reaching implications for international arbitration involving Russian entities. Practitioners should remain vigilant of the evolving geopolitical climate, as it may have a direct impact on the enforceability of such arbitral awards.

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