2011 REVIEW OF RUSSIAN COURT PRACTICE PERTAINING TO INTERNATIONAL COMMERCIAL ARBITRATION

November 29, 2011

To Our Clients and Friends:

In 2011, the Russian courts of last resort have issued a number of court decisions in specific cases where legal views have been formulated that are of vital significance for the development of international commercial arbitration. Below we present a review of the most important court decisions.

It is worth highlighting the following landmark conclusions reached by the Supreme Court of the Russian Federation (the "Supreme Court") and the Higher *Arbitrazh* Court of the Russian Federation (the "Higher *Arbitrazh* Court") in cases heard in 2011:

1. An incorrect determination of applicable law is not a ground for annulment of the award. An incorrect determination by an arbitral tribunal of the applicable substantive law does not in itself serve as a ground for annulment of an arbitral award.

2. The period for enforcement of an arbitral award is determined using the "3+3" formula. A person in favor of whom an arbitral award is made has three years to petition a Russian state court for recognition and enforcement of the arbitral award, and then another three years to serve the writ of execution through the court bailiffs' service (the so-called "3+3" formula).

3. A ruling on lack of jurisdiction cannot be challenged. Neither the Civil Procedural Code of the Russian Federation nor the *Arbitrazh* Procedural Code of the Russian Federation provide for bringing a challenge to a ruling by international commercial arbitration that a matter is outside its jurisdiction.

4. The application of foreign civil law concepts that do not exist in the Russian legal system does not in itself constitute a breach of Russian public policy. The application of foreign civil law concepts that do not exist in the Russian legal system does not contravene Russian public policy. Some of the concepts referred to by the courts include liquidated damages; warranties and representations by a seller regarding the absence of any indebtedness or undischarged obligations on the part of a legal entity in which interests are being sold; and survival of the obligations of a guarantor beyond the dissolution of a principal debtor.

5. It is not necessary to include in a power of attorney specific authority to execute arbitration clauses. A general power of attorney to enter into commercial transactions includes the authority to provide for an arbitration clause in respect of such transactions.

6. Involvement of a party to arbitration proceedings in the formation or funding of an arbitration court serves as grounds for annulment of an arbitral award issued by such arbitration court. Involvement of a party to arbitration proceedings in the formation of an institutional arbitration court, appointment of its bodies or funding of its operations violates the legal requirement of impartiality and independence during the conduct of arbitration proceedings and serves as sufficient grounds for invalidation of an arbitration clause, annulment of an arbitral award or rejection of a petition for enforcement.

7. Asset-stripping by means of a settlement agreement in arbitration proceedings in circumvention of the statutory transaction approval rules contravenes public policy. Asset-stripping of a company by a participant under the guise of an arbitral tribunal approving a settlement agreement that includes the transfer of property in circumvention of corporate law provisions on major and interested party transactions contravenes Russian public policy.

Certain of the court decisions were rendered in respect of arbitral awards made pursuant to Federal Law No. 102-FZ on Arbitration in the Russian Federation dated July 24, 2002 (the "Law on Arbitration"). However, they are also included in this review if the legal positions embodied therein can be applied to international commercial arbitration by virtue of the fact that the provisions of Law of the Russian Federation No. 5338-I on International Commercial Arbitration dated July 7, 1993 (the "ICA Law") are identical or largely similar.

Please find a more detailed review of the court decisions in Annex 1.

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We would be happy to discuss any questions you may have in relation to the above.

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ANNEX 1

COURT DECISIONS IN CASES PERTAINING TO INTERNATIONAL COMMERCIAL ARBITRATION

1. Ruling of the Presidium of the Higher *Arbitrazh* Court of January 13, 2011 No. 11861/10

Background. The Ukrainian company Delta Wilmar CIS (seller) and Russian company JSC Efirnoye (buyer) entered into an international contract for the sale of goods. The contract included an arbitration clause and governing law clause providing alternative options: if the action was brought by the seller, the dispute would be heard in the International Commercial Arbitration Court of the Chamber of Commerce and Industry of Ukraine (ICAC Ukraine), and if the action was brought by the buyer – in the International Commercial Arbitration Court of the Chamber of Commerce and Industry of the Russian Federation (ICAC Russia). The governing substantive law would be the law of the claimant's residence.

The first claim to be heard was brought in ICAC Ukraine by the Ukrainian seller. ICAC Ukraine settled the dispute by applying Ukrainian substantive law. The next claim (with a different claim for relief and cause of action) was brought in ICAC Russia by the Russian buyer. ICAC Russia, after invoking the applicability of Russian substantive law, settled the dispute on the basis of the provisions of the Vienna Convention 1980 on Contracts for the International Sale of Goods and the terms of the contract. The Ukrainian seller filed a motion with the Russian state commercial court to set aside the ICAC Russia award.

Principal legal issues dealt with in the case. The claimant believed that ICAC Russia had made an incorrect determination of the applicable substantive law. In its view, Ukrainian law, which had earlier been the basis for the award rendered by ICAC Ukraine, should have been applied. The lower courts agreed with the arguments of the claimant and concluded that failure by the arbitral tribunal to apply the law agreed by the parties constituted a violation of Russian public policy.

Legal positions formulated by the court. Citing violation of public policy as a ground to annulment the award of an arbitral tribunal requires that specific fundamental principles of the law be violated with specific legal consequences for the claimant in the form of impairment of its rights and lawful interests. However, the courts had not established the existence of such circumstances; in fact, the claimant had not itself cited such circumstances. Thus, the application by ICAC Russia of Russian law by reference to the Vienna Convention 1980 and the

provisions of the contract executed by the parties in itself could not be qualified as a violation of public policy.

It is important to note that the Presidium of the Higher *Arbitrazh* Court drew no conclusions regarding the invalidity or unenforceability of the alternative choice of law clause, despite the fact that there were doubts raised as to the admissibility of such clauses in the ruling handed down by the Higher *Arbitrazh* Court judges who referred the case to the Presidium of the Higher *Arbitrazh* Court.

2. Ruling of the Presidium of the Higher Arbitrazh Court dated March 9, 2011 No. 13211/09

Background. The German company Lugana Handelsgesellschaft mbH and the Russian company Ryazan Metal Ceramics Instrumentation Plant entered into a distributorship agreement under which any disputes were to be resolved in accordance with the rules of the German Institution of Arbitration. In 2005 the tribunal rendered a number of awards in favor of the German company, which then petitioned the Russian state *arbitrazh* courts for recognition and enforcement of the foreign arbitral awards. The arbitral awards were enforced in Russia only in 2010.[1]

Principal legal issues dealt with in the case. The Russian respondent disputed the effective date of the arbitral awards set forth in the writs of execution: in its opinion, such date should not have been the date on which the Presidium of the Higher *Arbitrazh* Court handed down its ruling on the recognition and enforcement of the foreign arbitral awards (2010), but rather the date that the arbitral awards were rendered (2005). For this reason, the Russian respondent argued, the three-year term provided for by procedural law for enforcement of a writ of execution, which could have been extended for only a three-month period, had expired (Art. 321 of the *Arbitrazh* Procedural Code).

[1] *Ruling of the Higher Arbitrazh Court of Russia No. 13211/09 dated February 2, 2010.*

Legal positions formulated by the court: Due to the combined effect of Art. 246 and Art. 321.1(1) of the *Arbitrazh* Procedural Code, the recognition and enforcement of a foreign arbitral award in Russia must take place within six years: three years are given for the voluntary performance of the award or filing of a petition with a court for the recognition and enforcement of the arbitral award, and another three years for the process of the execution of the writ.[2]

3. Ruling of the Presidium of the Higher *Arbitrazh* Court No. 1787/11 dated June 14, 2011

Background. The Austrian company HiPP GmbH & Co. Export KG (seller) and the Russian company OOO SIVMA Baby Food (buyer) entered into a distributorship agreement for the distribution of the seller's product in Russia. Under the terms of the distributorship agreement the parties were to sign separate supply agreements for individual consignments of goods. To secure the due performance of obligations under the supply agreements, a suretyship agreement was executed with the Russian company CJSC SIVMA. After obligations under the supply agreements were not duly performed, the Austrian seller filed a claim with the International Arbitral Centre of the Austrian Federal Economic Chamber against the buyer and the surety for joint and several recovery of the principal debt plus penalties. The Austrian arbitral tribunal awarded the claim to the seller. The seller petitioned the Russian state court for recognition and enforcement of the foreign arbitral award.

Principal legal issues dealt with in the case. The lower *arbitrazh* courts rejected the petition for recognition and enforcement of the foreign arbitral award on the grounds of the unenforceability of the arbitration clause included in the supply agreements, which purportedly did not confirm intent of the parties to have their disputes settled by the International Arbitral Centre of the Austrian Federal Economic Chamber. The arbitration clause provided that all disputes should be settled by arbitration in the country of the seller. Meanwhile, the distributorship agreement and suretyship agreement contained an arbitration

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[2] *The citing by the Presidium of the Higher Arbitrazh Court of a combined period of six years is not quite accurate: if a Russian state court rules in favor of the recognition and enforcement of an arbitral award before three years are up from the date the arbitral award was issued, the claimant has only another three years to serve the writ of execution through the court bailiffs' service for enforcement of the award. On the other hand, if the Russian state court rules in favor of the recognition and enforcement of the arbitral award after the expiration of three years from the date the arbitral award was rendered (in the case in question around four and a half years had elapsed), the claimant will have another three years to serve the writ of execution through the court bailiffs' service for enforcement of the award.*

agreement clearly specifying that all disputes were to be resolved precisely by the International Arbitral Centre of the Austrian Federal Economic Chamber. The claimant provided evidence that the International Arbitral Centre of the Austrian Federal Economic Chamber was the sole institutional arbitration court in Austria competent to hear disputes arising out of international contracts.

Legal positions formulated by the court. The Presidium of the Higher *Arbitrazh* Court reversed these court decisions and issued a ruling on the recognition and enforcement of the foreign arbitral award in Russia. The Presidium of the Higher *Arbitrazh* Court found no grounds for a review of the conclusions of the arbitral tribunal concerning jurisdiction, which were founded on the close interconnectedness of several agreements concluded by the parties, as well as the fact that there were no other institutional arbitration court in the country of the seller competent to hear disputes arising out of international contracts.

4. Supreme Court Ruling No. 41-V11-4 dated July 19, 2011

Background. The Belize company Mangista Ltd. (seller) and the Cypriot company United Company Rusal Secondary Aluminium Ltd. (buyer) entered into a sale and purchase agreement for a 100% participation interest in the Russian limited liability company BeLiS. The agreement was governed by English law, contained an arbitration clause specifying ICAC Russia, and included a whole range of representations and warranties of the seller, including a statement that BeLiS had no liabilities or undischarged obligations to third parties that had not been disclosed by the seller. At the same time, the Cypriot buyer and certain individuals residing in Russia (M.A. Pushkar and A.N. Pushkar) executed a so-called Deed of Guarantee and Indemnity, under which the guarantors undertook to be liable for performance by the seller of all obligations under the sale and purchase agreement for the participation interest, including the validity and enforceability of all representations and warranties of the seller. The Deed of Guarantee was governed by English law and contained an arbitration clause specifying ICAC Russia.

After completion of the transaction, a tax audit of BeLiS was conducted for the period during which it was controlled by the seller. The taxation authority found that taxes had been underpaid and imposed a number of fines. Judgments were handed down by the Russian state courts confirming the lawfulness of the actions of the taxation authority.

Principal legal issues dealt with in the case. The Cypriot buyer filed a claim with ICAC Russia for recovery of damages represented by a reduction in the assets of BeLiS that had occurred through the fault of the seller and in breach of the representations and warranties made by the seller. The claim named both the seller and the guarantors as respondents.

ICAC Russia awarded the claim against the seller, but terminated the arbitration proceedings against the guarantors on the grounds that ICAC Russia does not have jurisdiction to settle disputes involving natural persons who were not sole entrepreneurs or participants in entities with foreign ownership. The Cypriot buyer then filed a lawsuit against the guarantors in a court of common jurisdiction.[3]

The guarantors challenged the competence of the courts of common jurisdiction. In addition, they argued that the obligations set forth in the Deed of Guarantee had ceased, since the principal debtor (the seller) had gone through dissolution. It was the guarantors' belief that to award damages for breach of the representations and warranties would contravene the fundamental principles of Russian law, which did not embody such legal concepts.

Legal positions formulated by the court. The court rejected the arguments objecting to the competence of the courts of common jurisdiction, noting that challenges to the rulings of arbitral tribunals (in this case, ICAC Russia) on their lack of jurisdiction were not provided for in either the Code of Civil Procedure or the *Arbitrazh* Procedural Code. Furthermore, the court concluded that the grounds for termination of the guarantee agreement provided for in the Russian Civil Code did not apply, since the parties had agreed that the Deed of Guarantee would be governed by English law. Having established the relevant English rules with the help of an expert opinion, the court ruled that English law did not provide for the grounds for termination of the guarantee agreement cited by the guarantors. Finally, the court concluded that breach by the seller of its representations and warranties had led to a reduction in the assets of BeLiS that could be deemed damages recoverable by the buyer. Recovery of such damages does not contravene the fundamental principles of Russian law.

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[3] *One of the guarantors filed a petition with the state arbitrazh court to have the Deed of Guarantee deemed terminated, however; the case was ultimately dismissed because state arbitrazh courts do not have jurisdiction over disputes involving natural persons who are not registered sole entrepreneurs - see Ruling of the Federal Arbitrazh Court for the North Caucasus District dated April 26, 2011 in Case No. A53-15032/2010; Ruling of the Higher Arbitrazh Court No. VAS-10135/11 dated August 3, 2011 rejected the motion for review of the case under judicial supervision by the Presidium of the Higher Arbitrazh Court.*

5. Ruling of the Presidium of the Higher *Arbitrazh* Court No. 9899/09 dated September 13, 2011

Background. The Russian company OJSC Baltic Plant (contractor) and the Swedish company Stena RoRo (client) entered into a number of shipbuilding contracts. The parties chose Swedish law as the governing law. All disputes were to be heard under the rules of the Arbitration Institute of the Stockholm Chamber of Commerce. The Swedish arbitral tribunal awarded liquidated damages as set forth in the contract in connection with default by the Russian contractor of its obligations. The Swedish company applied to the Russian state *arbitrazh* court for recognition and enforcement of the foreign arbitral award.

Principal legal issues dealt with in the case. The courts of first and cassation instance rejected the petition for recognition and enforcement of the foreign arbitral award on the grounds of violation of Russian public policy. The violation in question was the fact that approval of the contracts by the board of directors of the Swedish company had not been formally set down in writing. In addition, the Russian courts ruled that the concept of liquidated damages was not embodied in Russian law and, therefore, recovery of such damages was in contravention of Russian public policy.

Legal positions formulated by the court. The rules for the procedure and recording of approval of major transactions by legal entities are determined by the law of the country where such legal entities are incorporated. Any disparities in such rules between the laws of different countries do not serve as grounds for conclusion on the lawfulness of the actions of one or other party to a contract by way of applying the statutory norms laid down in the law of the country of the other party to the contract. The rules laid down by Russian law for setting forth resolutions adopted by the bodies of Russian legal entities do not apply to Swedish companies. Furthermore, the procedure for approval of transactions, which the plant argues was not complied with, is designed to protect the interests of the shareholders/participants of the Swedish company and is not something that could give rise to violation of the rights of the plant.

In entering into contracts with a clause specifying that the governing law was Swedish substantive law, the plant assumed the risk that such legal regime could contain provisions differing from Russian legal norms governing similar matters. By their legal nature liquidated damages are similar to the concept of *neustoika* (penalty) used in Russian civil law. Given these circumstances, the courts should not have ruled that the recognition and enforcement of the arbitral award was in contravention of Russian public policy.

COURT DECISIONS IN CASES PERTAINING TO DOMESTIC ARBITRATION

1. Ruling of the Presidium of the Higher Arbitrazh Court No. 12311/10 dated April 12, 2011

Background. CJSC Tander, represented by its branch manager, and sole entrepreneur S.Y. Moiseeva entered into an agreement for the sublease of premises. The agreement included an arbitration clause specifying that all disputes were to be heard by the Arbitral Court for Economic Disputes of the Ulyanovsk Chamber of Commerce and Industry. Tander filed a claim with the state *arbitrazh* court to have the arbitration clause invalidated on the ground that the representative (branch manager) did not have the authority to sign the agreement.

Principal legal issues dealt with in the case. The branch manager had a general power of attorney to enter into civil law transactions on behalf of Tander. Tander argued that by virtue of Art. 62.2 of the *Arbitrazh* Procedural Code any authority to apply to an arbitral tribunal for resolution of disputes must be expressly specified in a power of attorney, otherwise the representative is not entitled to include arbitration clauses in any transactions.

Legal positions formulated by the court. The Law on Arbitration does not require that a power of attorney issued to a representative expressly set forth that such representative is authorized to enter into civil law contracts containing an arbitration agreement.[4] Thus, a general authority to enter into agreements allows a representative to enter into an agreement providing that disputes are to be heard by one or other arbitral tribunal for and on behalf of the principal who issued the power of attorney. Art. 62.2 of the *Arbitrazh* Procedural Code covers the cases where a matter already being heard in an *arbitrazh* court is referred to an arbitral tribunal. Such provision is not applicable to powers of attorney granting the right to enter into civil law contracts.

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[4] *The Russian Law on International Commercial Arbitration also does not contain such requirement.*

2. Ruling of the Presidium of the Higher *Arbitrazh* Court No. 17020/10 dated May 24, 2011

Background. Sberbank (lender) and OOO Business-Lada (borrower) entered into a number of loan agreements. To secure the performance of the obligations of the borrower suretyship agreements were entered into with OOO Firma Lada-Forward, OOO Business-Trans and L.S. Akhmadov (guarantors). Following a default under the loan agreements, the lender filed a claim against the borrower and the guarantors for joint and several recovery of the principal debt plus penalties.

The loan agreements and suretyship agreements included an arbitration agreement in favor of the Arbitration court of CJSC Investment and Construction Company Sberbankinveststroy. The arbitral tribunal awarded the claim to the lender. The lender applied to the state *arbitrazh* court for a writ of execution to be issued for enforcement of the arbitral award.

Principal legal issues dealt with in the case. The chairman of the arbitration court and his deputies, as well as the list of arbitrators, were all approved by the general shareholders' meeting of CJSC Investment and Construction Company Sberbankinveststroy. Sberbank (lender) was an affiliate of CJSC Investment and Construction Company Sberbankinveststroy and part of the Sberbank banking (consolidated) group. Sberbank as shareholder was involved in the appointment of the chairman of the arbitration court and approval of the list of arbitrators.

The respondents argued that in such situation the arbitration court could not guarantee adherence to the principle of impartiality and independence in the course of the arbitration proceedings. The principal issue was related to the fact that applicable law sets forth the requirement of impartiality and independence for specific arbitrators hearing a case, but does not explicitly lay down any standards applying to institutional arbitration courts administering arbitration of a dispute.

Legal positions formulated by the court. The fact that the lender was simultaneously an entity that had been involved in setting up the institutional arbitration court and a party to a dispute gave rise to a breach of the principles of equality and autonomous will of the parties. The creation and funding of an arbitration court by one of the counterparties to a civil law contract and settlement of disputes arising out of such contract by the arbitral tribunal composed by the aforementioned arbitration court, where the other party is deprived of such opportunities, is evidence of violation of the guarantees of objective impartiality and, therefore, fair and equitable consideration of a case. Such violation of itself is a sufficient

ground for dismissal of an application for a writ of execution to be issued for enforcement of an arbitral award.

3. Ruling of the Presidium of the Higher *Arbitrazh* Court No. 1308/11 dated June 28, 2011

Background. OOO First Excavator Company and OJSC Industrial Union Rosprom entered into a partnership agreement. Following termination of this agreement First Excavator Company filed a claim with the state *arbitrazh* court for recovery of its contribution to the property of the partnership. The state *arbitrazh* court referred the parties to arbitration on the grounds that the parties had concluded an arbitration agreement specifying that all disputes were to be heard by the Arbitration Court of OJSC Industrial Union Rosprom.

Principal legal issues dealt with in the case. The claimant referred to the fact that the chairman of the institutional arbitration court was approved by the President of Rosprom, *i.e.*, the chief executive of the respondent. The chairman of the institutional arbitration court was the head of the legal department of Rosprom. The panel of arbitrators was appointed by the chairman of the institutional arbitration court, with the parties having no say in the formation of the arbitral tribunal. The claimant believed that in such a situation the arbitral tribunal could not guarantee adherence to the principle of impartiality and independence in the course of the arbitration proceedings. For this reason the arbitration agreement should be deemed invalid.

Legal positions formulated by the court. The procedure laid down for formation of the institutional arbitration court does not provide for adherence to the principle of impartiality of the arbitral tribunal in adjudicating a dispute, which also applies to the institutional arbitration court as a body administering the adjudication of disputes. Thus, the lack of compliance of the arbitration clause and the procedure for forming the arbitral tribunal with the principle of impartiality of arbitration proceedings is a good and sufficient reason for invalidation of the arbitration agreement concluded by the parties. The existence of such agreement cannot by virtue of Article 148.1(5) of the *Arbitrazh* Procedural Code serve as an obstacle to consideration of a claim filed by one of the parties to such agreement with the *arbitrazh* court.

4. Ruling of the Presidium of the Higher *Arbitrazh* Court No. 1884/11 dated June 14, 2011

Background. OOO Rona made an advance payment to OOO Svarschik for the delivery of goods. The dispute regarding refund of the advance payment was referred by the parties to the Arbitration Court of the Chamber of Commerce and Industry of Korolev, Moscow Region. In the course of the arbitration proceedings a settlement was reached whereby for the purposes of repaying the debt OOO Svarschik undertook to transfer title to certain immovable property to OOO Rona. One of the participants of OOO Svarschik, Mr. S.S. Moiseev, filed a petition with the state *arbitrazh* court for annulment of the arbitral award approving the settlement.

Principal legal issues dealt with in the case. Mr. Moiseev was not a party to or otherwise involved in the arbitration proceedings. His argument was that the settlement approved by the arbitral tribunal was a scheme to strip OOO Svarschik of its assets in violation of the corporate law rules on major transactions and interested party transactions. Evidence was presented that the second participant of OOO Svarschik, Mr. S.V. Vasiliev, was also the sole participant of OOO Rona.

Legal positions formulated by the court. State *arbitrazh* courts set aside the awards handed down by arbitral tribunals if it is shown that they violate the fundamental principles of Russian law, including those aimed at protecting individuals not involved in the arbitration proceedings and whose consent was not obtained (Paragraph 6 of Ruling No. 10-P of the Constitutional Court dated May 26, 2011). Russian public policy assumes the good faith of the parties entering into private relations, and it is a violation of such good faith if a pretext is made of an ostensible private law dispute, with its ensuing referral to an arbitral tribunal in order to obtain formal grounds for the alienation of immovable property as a means for a participant to strip a company of its assets. Thus, the asset-stripping of a company by one of its participants under the guise of approval by an arbitral tribunal of a settlement for the transfer of title to property in circumvention of statutory provisions on major transactions and interested party transactions is a violation of the fundamental principles of Russian law.