CONSTITUTIONAL COURT OF THE RUSSIAN FEDERATION RECOGNIZES THE RIGHT OF ARBITRAL TRIBUNALS TO HEAR REAL PROPERTY DISPUTES

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To Our Clients and Friends:

On May 26, 2011, the Constitutional Court of the Russian Federation (the “Constitutional Court”) issued Ruling No. 10-P after testing the constitutionality of a number of Russian law provisions relating to consideration by arbitral tribunals of civil law disputes in respect of real property, including those pertaining to a levy of execution on mortgaged property (the “Ruling”).

The Ruling is significant because it was the first time that the Constitutional Court examined the constitutionality of a number of key legislative provisions relating to arbitral tribunals in the form of a ruling and examined at length the legal nature of arbitration, as well as ways of ensuring compliance with constitutional guarantees when referring a dispute to arbitration.

Consideration of the matter was prompted by a request from the Presidium of the Higher Arbitrazh Court of the Russian Federation (the “Higher Arbitrazh Court”), which touched on the issue of arbitrability, i.e., the question of whether certain categories of disputes could be heard by arbitration. Issues of arbitrability (especially in relation to real property) are traditionally some of the more hotly debated and thorny questions in Russian practice and legal doctrine.

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1 The Constitutional Court had previously made a number of determinations that dealt with certain legislative provisions on arbitral tribunals.
PERMISSIBILITY OF RESOLUTION BY ARBITRAL TRIBUNALS
OF REAL PROPERTY DISPUTES PRIOR TO THE RULING

The referral of civil law disputes to arbitral tribunals for resolution is provided for in Art. 1.2 of Law of the Russian Federation No. 5338-I on International Commercial Arbitration, (the “ICA Law”) and Art. 1.2 of Federal Law No. 102-FZ on Arbitration in the Russian Federation (the “Arbitration Law”). A number of other legislative acts also specifically mention certain categories of disputes that may be submitted to arbitration.\(^2\) Art. 11.1 of the Russian Civil Code states that arbitral tribunals are also charged with protecting violated or disputed civil law rights, together with courts of common jurisdiction and state arbitrazh courts.

Art. 1.4 of the ICA Law and Art. 1.2 of the Arbitration Law provide that if one or other type of dispute arising out of civil law relations may not be submitted to arbitration, this must be expressly stated in a federal law. At present there is only one such prohibition known in Russian law: Art. 33.3 of Federal Law No. 127-FZ on Insolvency/Bankruptcy provides that bankruptcy cases may not be submitted to arbitration.\(^3\)

However, in practice the Russian state arbitrazh courts have taken a restrictive approach, deeming that many categories of civil law disputes may not be submitted to arbitration. In particular, Letter of the Higher Arbitrazh Court No. VAS-S06/OPP-1200 sets forth that confirmation of title to real property could only be made by state courts of the Russian Federation at the location of such property, while the awards of arbitral tribunals on title to real property were “unenforceable and can be set aside.”


\(^3\) This prohibition does not automatically rule out the referral to an arbitral tribunal of ordinary civil law disputes involving a legal entity in respect of which bankruptcy proceedings have been initiated in a competent state court. In accordance with Art. 63.1 of the Federal Law on Insolvency/Bankruptcy, proceedings in cases for the recovery of monetary debts may be discontinued only upon the relevant petition of a creditor after a state arbitrazh court has introduced a supervision procedure in respect of a debtor.
ARGUMENTS REGARDING NON-ARBITRABILITY OF REAL PROPERTY DISPUTES

In its original request (No. VAS-S01/UMPS-1571 dated July 29, 2010), as well as in the later addendum (No. VAS-S01/UMPS-2681 dated December 30, 2010) the Higher Arbitrazh Court made a number of arguments in favor of the non-arbitrability of real property disputes and, accordingly, pointed to contradictions to the Russian Constitution of such legal norms that recognize the permissibility of referring this category of dispute to arbitration. The Constitutional Court found all of these arguments to be unjustified. Let us examine some of the more important of these in more detail.

ARBITRAL TRIBUNALS ARE NOT COURTS UNDER THE RUSSIAN CONSTITUTION

- **Higher Arbitrazh Court argument:** Arbitral tribunals are not part of the Russian court system and are not courts under Art. 45 of the Russian Constitution. Therefore, in the opinion of the Higher Arbitrazh Court, an award by an arbitral tribunal to levy execution on mortgaged real property constitutes deprivation of a person (the pledgor) of its ownership title without a court judgment, which contravenes Art. 35.3 of the Russian Constitution.

- **Counterarguments of the Constitutional Court:** While arbitral tribunals do not exercise state (judicial) power and are not part of the Russian court system, parties may voluntarily waive their constitutional right to recourse to a state court for resolution of a dispute based on the principles of free disposition of rights, autonomy of will and freedom of contract. The constitutional guarantees of the right to judicial recourse will be adhered to by virtue of the application of two institutions ensuring control of state courts over arbitral awards: consideration by the state court of a petition to set aside an arbitral award, and a petition for service of a writ of execution for the enforcement of an arbitral award.

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4 The original request and the further addendum by the Higher Arbitrazh Court can be found at [http://pravo.ru/interpravo/doc/view/226/](http://pravo.ru/interpravo/doc/view/226/)
PUBLIC LAW ELEMENT PRESENT

- **Higher Arbitrazh Court argument**: Disputes involving real property have “a significant public law element, since they may give rise to the transfer of rights to expensive property and amendment of state registers of rights to real property.” In the opinion of the Higher Arbitrazh Court, arbitral tribunals cannot hear civil law disputes “involving a public law element,” since by their nature arbitral tribunals “protect only private interests.”

- **Counterarguments of the Constitutional Court**: The public law nature of a dispute is determined by the specific features of the legal relationship and the parties involved in the dispute, but not by the type of property (movable or immovable (real) property) involved. The requirement concerning state registration of real property is not related to the parties to the dispute or to the nature of the legal relationship, and therefore is not a factor in determining or changing the civil law nature of relations involving real property.

The Constitutional Court came to a decision on the wrongfulness of the legal position earlier reflected in Paragraph 27 of Information Letter No. 96 of the Higher Arbitrazh Court dated December 22, 2005 “Review of Arbitrazh Court Practice on Recognition and Enforcement of Foreign Court Judgments, Challenge of Arbitral Awards and Issue of Writs of Execution for the Enforcement of Arbitral Awards.” In this Information Letter, the Higher Arbitrazh Court wrongly qualified matters related to the state registration of real property as public law matters that could not be dealt with by arbitral tribunals.

The Constitutional Court specifically noted that any arbitral award requiring that changes be recorded in the state register of rights to real property will either be performed by the debtor voluntarily (i.e., the debtor will voluntarily submit the full set of documents required to make changes to the register to the state registrar) or a writ of execution will have to be obtained from the state courts. Therefore, an arbitral award does not in itself serve as the basis for the performance by the state registrar of the registration functions.

EXCLUSIVE JURISDICTION OF RUSSIAN STATE COURTS

- **Higher Arbitrazh Court argument**: The reference in Art. 248.1(2) of the APC that disputes on rights to real property fall within the exclusive jurisdiction of Russian state arbitrazh courts means that no other body (including arbitral tribunals) may hear such disputes.
• **Counterarguments of the Constitutional Court:** Article 248 of the APC is aimed at the delineation of the jurisdiction of the state courts of various countries in considering transborder disputes. It prohibits parties from entering into prorogatory agreements (agreements on the referral of disputes to the state courts of other countries), but not from entering into arbitration agreements on the resolution of disputes by international commercial arbitration.5

**RIGHTS OF THIRD PARTIES**

• **Higher Arbitrazh Court argument:** Disputes involving real property often touch upon the rights and obligations of third parties that have not given their consent to resolution of the dispute in arbitration. The procedural features of hearing a case by arbitration prevent third parties from effectively exercising their right to judicial recourse.

• **Counterarguments of the Constitutional Court:** If an arbitral award is rendered that touches on the rights and obligations of persons that were not involved in the arbitral proceedings, they are entitled not only to file a separate claim with the competent court, but to petition the court on their own behalf to set aside the arbitral award. Such approach – previously expressed by the Constitutional Court in relation to courts of common jurisdiction (Determination No. 1086-O-P dated December 18, 2008) – now also applies to challenges to arbitral awards in state arbitrazh courts. In addition, when considering applications for the issue of a writ of execution for the enforcement of an arbitral award state courts must also verify whether or not the rights and obligations of third parties have been affected by the arbitral award.

In view of the above, the Constitutional Court found that the legal provisions in question did not contravene the Constitution, and confirmed that arbitral tribunals had the right to hear disputes involving real property, including disputes to levy the execution on real property.

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5 This means that in the opinion of the Constitutional Court there are no grounds to differentiate the limits of jurisdiction of domestic arbitral tribunals, on the one hand, and international commercial arbitration, on the other. Such delineation was previously proposed by certain members of the Higher Arbitrazh Court (see, e.g., Letter No. V-AS-506/OPP-1200 of the Higher Arbitrazh Court dated August 23, 2007).
ISSUES NOT RESOLVED BY THE CONSTITUTIONAL COURT

APPLICATION OF LEGAL POSITIONS TO INTERNATIONAL COMMERCIAL ARBITRATION

The Constitutional Court discontinued its deliberations when it came to testing the constitutionality of the ICA Law. The dispute that had served as the catalyst for the request to the Constitutional Court did not contain issues of the application of the ICA Law, and the Presidium of the Higher Arbitrazh Court was not empowered to refer questions on the constitutionality of federal laws simply for the sake of testing the theoretical underpinnings of legal norms.

Nevertheless, it would appear that the legal positions expressed by the Constitutional Court on the permissibility of arbitral tribunals hearing real property disputes should apply equally to international commercial arbitration. This is supported by the fact that the statutory regulation of the limits of the arbitrability of disputes is worded almost identically in the Arbitration Law and the ICA Law. Furthermore, there are certain conclusions drawn in the Ruling of the Constitutional Court (e.g., with regard to Art. 248 of the APC) that are relevant to international commercial arbitration, since they refer to transborder disputes.

APPLICATIONS BY THIRD PARTIES NOT INVOLVED IN ARBITRATION PROCEEDINGS

The Constitutional Court decided that an arbitral tribunal could not hear a dispute that touched upon the rights and obligations of persons who had not been involved in the proceedings and had not given their consent to such involvement in the course of the arbitration proceedings. The Constitutional Court also believed that an arbitral award should be set aside (or an application for the issue of a writ of execution for its enforcement should be rejected) not only on the ground that it contains rulings on matters beyond the scope of the arbitration agreement, but also because such arbitral award contravenes the fundamental principles of Russian law. Such principles include the provision set forth in Art. 46.1 of the Russian Constitution, which grants every person the right to take part in any proceedings in which such person’s rights and obligations are under consideration.

Unfortunately, the Ruling does not specify in what cases the rights and obligations of third parties can be deemed to have been touched upon, requiring the annulment of the relevant arbitral award or rejection of the application for enforcement. This allows state courts rather broad discretion for interpretation.

In particular, Ruling No. 1884/11 of the Higher Arbitrazh Court dated June 14, 2011 set aside an arbitral award on the petition of a participant (shareholder) in a limited liability
company. The petitioner argued that its rights and lawful interests had been affected by the fact that in a dispute involving the limited liability company the arbitral tribunal had approved a settlement that provided for the transfer of the real property of the limited liability company to the claimant. The Higher Arbitrazh Court cited paragraph 6 of the declarative part of the Ruling and stated that the asset-stripping of a company under the guise of approval by an arbitral tribunal of a settlement for the transfer of property in circumvention of statutory provisions on major transactions and interested party transactions is a violation of the fundamental principles of Russian law.

There is a risk that third parties (e.g., shareholders or participants of a party to arbitration proceedings) could file petitions for the annulment of arbitral awards as a common tactic aimed at the unjustified circumvention of an arbitral award.

ARBITRABILITY OF CORPORATE DISPUTES

The Constitutional Court did not explicitly state its position on the point of view sometimes expressed by state courts that the categories of disputes set forth in Art. 33 of the APC (“Cases Falling Under the Special Jurisdiction of Arbitrazh Courts”) cannot be referred to arbitration. Art. 33 of the APC includes corporate disputes, among others. This issue has become particularly timely following the inclusion in the APC of a new chapter 28.1. (“Consideration of Cases on Corporate Disputes”), which provides an extremely broad definition of a corporate dispute. It defines corporate disputes not only as disputes between a legal entity and its shareholders or participants, but also as disputes related to the ownership of shares or participation interests in companies, the imposition of encumbrances thereon and the exercise of rights arising therefrom. As a result, there is uncertainty as to the question of whether or not disputes arising out of sale and purchase agreements or pledge agreements for shares or participation interests in Russian commercial entities may be referred to an arbitral tribunal or international commercial arbitration.

We will be providing updates on further developments in court practice on this issue.
In conclusion, a number of important changes are being planned to Russian legislation on arbitration. A bill has been tabled before the State Duma of the Federation Council of the Russian Federation on amendment of the Law on ICA that contemplates a series of important innovations, such as the right of an arbitral tribunal acting under the ICA Law to grant *ex parte* preliminary interim relief. This bill is aimed at incorporating the amendments introduced in 2006 to the UNCITRAL Model Law on International Commercial Arbitration.

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

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