WILMERHALE

LITIGATION/CONTROVERSY

31 August 2016

International Arbitration Alert

Russia Implements Arbitration Reform

By Steven P. Finizio and Dmitry Andreev

Russia has significantly revised its arbitration laws as of 1 September 2016. On that date, two laws—the Federal Law "On Arbitration (Arbitral Proceedings) in Russia"[1] and the Federal Law No. 409-FZ—come into effect, and amend a number of existing laws regulating arbitration.[2] The new laws, commonly referred to as the "arbitration reform," change considerably the legal framework for arbitral proceedings in Russia.

Among other developments, the reform:

- addresses the arbitrability of "corporate disputes" (described in more detail below and in Chart 1);
- introduces mandatory licensing of arbitral institutions;
- creates certain benefits for institutional arbitration as compared to ad hoc arbitration;
- adopts a presumption of arbitrability of disputes and identifies a revised list of disputes that are not arbitrable (these are discussed below and listed in Chart 2);
- introduces eligibility requirements for arbitrators in international arbitrations; and
- provides for greater role for local courts in assisting with formation of arbitral tribunals and the taking of evidence, while also allowing parties to exclude the courts from taking certain steps (such as assisting in the formation of the tribunal and reviewing awards) in some circumstances.

These developments are described in more detail below.

Background of the Reform

The revised laws have several objectives:

- **Make arbitration in Russia more attractive.** Russian arbitration law has been criticized for being unpredictable, including with regard to whether certain intra-company or "corporate disputes" involving Russian companies and their shareholders could be submitted to arbitration. The reform attempts to make arbitration in Russia more attractive by permitting these disputes to be arbitrated if the seat of arbitration is in Russia and also provides other benefits for arbitrations seated in Russia.

[1] This law replaces the Federal Law "On Arbitral Tribunals in Russia" that governed domestic arbitration.
[2] The new laws amend, *inter alia*, the Law of Russia "On International Commercial Arbitration" (ICA Law), the Civil Procedure Code of Russia (CPC), and the Arbitrazh [Commercial] Procedure Code of Russia (APC).

- **Outlaw "pocket" arbitrations.** There are an enormous number of little-known arbitral institutions in Russia. Many were set up by Russian companies to resolve disputes under their own contracts and raise issues of conflicts of interest. There also are suggestions that some have been used for illegal purposes, for example to create fictitious debts in bankruptcy, or to launder the proceeds of crime. One of the goals of the reform is to regulate arbitral institutions.

- **Harmonize multiple laws on arbitration.** Russia has a dual system of arbitration with separate bodies of law on domestic and international commercial arbitration. Russian courts often mix these laws and there also are additional provisions related to arbitration in judicial codes of procedure. These various provisions often overlap or even contradict each other. The reform is intended to harmonize the laws on arbitration and reduce the current confusion.

- **Take into account UNCITRAL Model Law developments.** While the Russian law on international commercial arbitration was based on the 1985 UNCITRAL Model Law, the Russian law on domestic arbitration was not. Under the reform, both laws will follow the structure and contents of the UNCITRAL Model Law including the 2006 amendments.

Russia is not a leading arbitration jurisdiction and many foreign parties try to avoid agreeing to arbitration in Russia. However, the arbitration reform may make it more attractive, and in some cases even advisable, to choose Russia as an arbitral seat. Key elements of the new laws are discussed below.

Russia as a Seat of Arbitration

Currently, many Russia-related disputes are resolved in foreign-based arbitrations. However, as part of a campaign to promote arbitration in Russia, the reform is intended to create advantages if Russia-related disputes are arbitrated in Russia.

- **Intra-company disputes.** Before the reform, corporate disputes between companies incorporated in Russia and their shareholders were considered non-arbitrable. As part of the reform, many intra-company matters that arise out of articles of association, shareholder agreements, and other corporate governance arrangements will become arbitrable on the condition that the arbitration is seated in Russia. The arbitrability of corporate disputes is discussed further below.

- **Taking of evidence.** Following the reform, an arbitral tribunal seated in Russia, or a party authorized by such a tribunal, will be able to request assistance from the Russian courts in obtaining evidence located in Russia. This assistance will not be available for cases seated outside Russia.

  Under the new laws, when a court is asked to assist in the taking of evidence, the court will hold a hearing on the request and can subpoena any tangible or documentary evidence from any person or entity within Russia.[3] However, the courts do not have the authority to obtain witness testimony.[4]

- **Speedier post-award litigation.** The reform is intended to simplify post-award petitions in Russian courts by essentially merging annulment and enforcement proceedings. Under the reform, if a party seeks to annul an arbitral award in Russia and fails, the award becomes immediately enforceable in Russia without need for any further enforcement action. Conversely, if a party seeks to enforce an award in Russia and fails, the award loses its preclusive effect and neither party needs to have it vacated before filing a new claim. In addition, from 1 January 2017, the statutory time for the courts to rule on annulment and enforcement petitions will be reduced from three months to one month after a respective petition has been filed.

[3] There are certain restrictions on the evidence that can be requested. For example, the court cannot order the production of evidence that is subject to confidentiality obligations to a non-party to the arbitral proceedings (for example, a non-party's bank records) or that raises national security issues.
[4] See CPC Art. 63.1, APC Art. 74.1.

Regulation of Arbitral Institutions

As part of the response to "pocket" arbitrations, the reform introduces mandatory licensing of arbitral institutions that seek to administer arbitrations in Russia.

The two best-known arbitral institutions in Russia—the International Commercial Arbitration Court (ICAC) and the Maritime Arbitration Commission (MAC)—will be licensed automatically by operation of law. Other Russian and foreign arbitral institutions will have to obtain a license, which will be issued based on a recommendation from the newly established Arbitration Development Council at the Ministry of Justice.[5]

The government will start issuing licenses on 1 November 2016. Existing arbitral institutions will be able to administer arbitrations without a license until 1 November 2017. After that date, parties who have agreed to arbitrate in Russia under the auspices of a non-licensed institution will be considered to be arbitrating on an ad hoc basis (as discussed below, under the revised laws, there are certain disadvantages to ad hoc arbitration).

In addition to being licensed, arbitral institutions based in Russia will have to deposit all of their arbitration rules with the Ministry of Justice. A Russian arbitral institution will not be able to administer proceedings under a set of arbitration rules that has not been deposited.

Finally, while parties are still free to arbitrate in Russia before an ad hoc tribunal (or in a proceeding not administered by a licensed arbitral institution and therefore deemed to be an ad hoc arbitration), the new laws create a number of disadvantages for ad hoc arbitration as compared to institutional arbitration. Among other things, in an ad hoc arbitration, parties cannot:

- arbitrate "corporate disputes" (as defined above);
- request assistance from a Russian court in the taking of evidence; or
- waive the right to request Russian courts to assist in the constitution of the tribunal or the right to seek judicial review of interim or final arbitration awards on any grounds.

Arbitration of Corporate Disputes

From 1 February 2017, parties will be able to enter into arbitration agreements in respect of most corporate disputes.[6] The revised laws put all corporate disputes into three categories as detailed in Chart 1 below.

The first category is corporate disputes involving a public interest. These disputes may concern an act of a notary public, a decision of a public authority in respect of issuing shares, or a company designated as "strategic" under Russian law (e.g. a company involved in national security and defense). This category of disputes is non-arbitrable and can therefore be heard only in a Russian court.

The second category is corporate disputes relating to shares in a Russian company. These disputes typically arise out of share purchase agreements, liens on shares, or contracts with custodians of shares. Following the reform, parties are free to arbitrate this category of disputes, but the proceedings must be administered by an arbitral institution (and, if the seat of arbitration is Russia, it must be a licensed institution).

The third category is intra-company disputes relating to a Russian company. These disputes concern internal governance of the company and can arise out of articles of association, shareholder agreements, and other types of corporate arrangements.

To submit this type of disputes to arbitration, parties have to comply with four conditions:

[5] See Arbitration Law Art. 44.
[6] See 409-FZ Law Art. 13(7). While the new laws are not clear on this point, the predominant view is that the execution date of the arbitration agreement must be 1 February 2017 or later, although the dispute itself may arise before that date.

(a) The company, all of its shareholders, and any third parties involved in the dispute (for example, a company's counterparty) must enter into an arbitration agreement.

To make it easier for the company and its shareholders to sign an arbitration agreement, the reform allows an arbitration clause to be incorporated into a company's articles of association. This clause must be adopted by unanimous vote of all of its shareholders. This option is not available for publicly traded joint-stock companies and joint-stock companies with more than 1000 shareholders. Further, such a clause will not bind a third-party, who will still need to consent to arbitration separately.[7]

(b) The seat of arbitration for these disputes must be in Russia.

(c) The arbitration must be administered by an arbitral institution licensed in Russia.

(d) The arbitral institution must have special rules of arbitration for corporate disputes. Because the purpose of these rules is to protect the interests of all shareholders of the company, the new laws require that these rules have certain provisions. For example, these rules must provide that, when a dispute in this category arises, the arbitral institution must notify the company about the claim and publish a notice of the case on its website. The company must then notify all of its shareholders about the claim. The rules must also provide that any shareholder of the company can join the arbitral proceedings, receive notices and relevant documents about the case, and object to any procedural actions that take place after its joinder.[8]

If these conditions are not met for this category of corporate disputes, the arbitration agreement will be inoperative in Russia. Therefore, if a foreign party wishes to subject these types of disputes to arbitration (for example, in a Russia-based joint venture), it should carefully draft and execute the arbitration agreement to comply with these requirements.

Presumption of Arbitrability and Non-Arbitrable Disputes

Before the reform, Russian courts were split on whether a statutory provision that certain disputes "shall be resolved in national courts" made those disputes non-arbitrable. This created significant uncertainty as to whether certain categories of disputes could be submitted to arbitration. In response, the reform introduces a presumption that a dispute is arbitrable unless the law expressly states that it cannot be submitted to arbitration.[9]

Following the reform, a number of issues will continue not to be arbitrable in Russia. For example, labor disputes, disputes arising out of government or municipal procurement of goods and services, and intellectual property disputes where a party contests a patent will not be arbitrable. A list of disputes that will be non-arbitrable in Russia from 1 September 2016 is provided in Chart 2 below.

Regulation of Arbitrators

The reform also amends various legal provisions affecting arbitrators.

- **Eligibility.** Previously, Russia had eligibility requirements for arbitrators only in domestic arbitration. The new laws expand these requirements to international commercial arbitration. Following the reform, an arbitrator:

  - must have legal capacity to enter into a contract and be at least 25 years old;

  - must have no criminal or disciplinary record that would lead to his or her suspension as a lawyer;

[7] Arbitration Law Art. 7(7), ICA Law Art. 7(8).
[8] See Arbitration Law Art. 45(8).
[9] CPC Art. 22.1, APC Art. 33.

- must not be a government official, although can be a retired ("emeritus") judge; and

- must have a law degree officially recognized in Russia if he or she is the sole arbitrator or the president of the tribunal (parties may waive this requirement for sole arbitrators or if another member of the tribunal has such a degree).[10]

- **Number.** Previously, the law required an odd number of arbitrators only in domestic arbitration and allowed an even-numbered tribunal in international commercial arbitration. The new laws mandate that all tribunals, with the exception of the Maritime Arbitration Commission, must have an odd number of arbitrators.[11]

- **Tribunal formation.** Previously, Russian courts did not play any role in the appointment, challenge, or removal of arbitrators. If the parties' agreed procedure for appointing the tribunal failed, the President of the Chamber of Commerce and Industry would assist in the context of international commercial arbitration, and in the context of domestic arbitration the arbitration agreement would become inoperative. Under the new laws, the parties may ask a competent court to step in and appoint, consider a challenge, or replace an arbitrator. The President of the Chamber of Commerce and Industry will continue to assist only in ICAC and MAC arbitrations.[12]

- **Liability.** Previously, the law was silent on whether an arbitrator may be liable to the parties for failing to fulfill his or her duties. The new laws provide that an arbitrator is immune from any liability to the parties, except where he or she was convicted of a crime related to the arbitral proceedings (for example, on corruption charges) and the criminal court's sentence provides for indemnification of damages caused to the victims of the crime.[13]

Recommendations for Drafting Arbitration Agreements

While the new laws do not affect the validity of arbitration agreements concluded before 1 September 2016, they will apply to arbitration agreements concluded on or after that date. In light of the reform, there are certain issues parties may want to consider in Russia-related arbitration agreements.

- **Seat.** As discussed above, under the reforms, many types of corporate disputes can now be arbitrated if the seat of arbitration is in Russia and the Russian courts can provide certain assistance to arbitrations seated in Russia. Therefore, parties who want to take advantage of these new options should include an express choice-of-seat provision in their arbitration clause and specify that any arbitration will be seated in Russia (and specifically designate the region in Russia they have chosen as the seat).

- **Institution.** If parties want to avoid having their Russian-seated arbitration deemed to be ad hoc, and want to take advantage of the benefits for institutional arbitration under the reform, they should ensure that the designated institution has an active license from the Government of Russia. It may also make sense to agree on an alternative institution in the arbitration agreement in case the institution of first choice loses its license or ceases to exist without a successor.

- **Scope.** The new laws adopt an arbitration-friendly approach towards the interpretation of arbitration agreements. Unless the parties have agreed otherwise, an arbitration clause in the parties' contract will be deemed to cover:

  - related transactions that perform, amend, or terminate the contract;

  - the conclusion, entry into force, amendment, termination, and validity of the contract;

[10] See Arbitration Law Art. 11. The Russian degree recognition procedure may be a hurdle for arbitrators educated outside the CIS region and foreign arbitrators may be reluctant to accept nominations given the issues that it may raise.
[11] Arbitration Law Art. 10, ICA Law Art. 10.
[12] See Arbitration Law Art. 6, ICA Law Art. 6.
[13] Arbitration Law Art. 51.

- restitutionary remedies should the tribunal decide that the contract is void or "deemed unconcluded" due to a legal defect; and

- assignees of rights and those who assume obligations under the contract.[14]

Parties who wish to exclude any of these issues from the scope of arbitration should do so explicitly in the text of the arbitration clause. They can always expand the scope of arbitration as well.

- **Waivers.** The reform allows parties to agree in an arbitration agreement to waive certain rights:

  - to request a competent court to assist in the formation of the tribunal;

  - to seek judicial review of an interim award on jurisdiction;

  - to seek annulment of the final award on any grounds (by including a statement that "the award will be final"); and

  - in the context of domestic arbitration—to demand an oral examination of the case if the tribunal does not consider that a hearing is needed.

  To be effective, these waivers must be made expressly in the text of the arbitration agreement and cannot be incorporated by way of reference to a set of arbitration rules.[15]

  Further, parties may wish to waive the requirement that the sole arbitrator or the president of the tribunal must have a law degree recognized in Russia.

- **Post-award litigation.** Finally, the new laws allow the parties to agree in advance on the venue for filing annulment and enforcement petitions in Russia. In respect of annulment petitions, the parties can contractually choose the court of the region where the tribunal sits or where one of the parties is domiciled. For enforcement actions, the parties can pick the court of the region where the debtor's domicile or assets are, where the tribunal sits, or where the creditor is domiciled.[16]

  Russian territory has 85 regions that span across ten time zones. To save legal and travel expenses, parties may want to limit post-award venues and select the court of the region where the seat of arbitration is for both annulment and enforcement petitions.

* * *

For more information on this or other international arbitration matters, contact:
Steven Finizio +44 (0)20 7872 1000 Steven.Finizio@wilmerhale.com

[14] Arbitration Law Art. 7(9)-(11), ICA Law Art. 7(10)-(12).
[15] See Arbitration Law Art. 7(12), ICA Law Art. 7(13).
[16] CPC Art. 30.1, APC Art. 38.

CHART 1
ARBITRABILITY OF CORPORATE DISPUTES

Disputes involving a public interest				
Cannot submit to arbitration – must bring claim in a Russian court				
• convocation of a meeting of a company's shareholders • challenge of notary public acts (e.g., to certify transactions between LLC members) • annulment of acts or decisions of public authorities (e.g., to approve share issuance) • disputes in respect of a "strategic" company in which the Government of Russia has to approve any change in ownership, except where the dispute concerns a stock of small percentage (typically less than 25%) that requires no approval from the Government • buy-back or redemption of shares, as well as mandatory or voluntary tender offers of shares in a joint-stock company • expulsion of an LLC member				
Disputes in respect of shares in a Russian company				
Can submit to arbitration	*Must be administered by an arbitral institution*			
• disputes related to ownership and encumbrance of shares in a company (e.g., share purchase agreements, liens of shares, other M&A transactions) • disputes related to services of custodians and brokers of shares in a company (e.g., instructions to sell, purchase, or vote with shares) • any other disputes concerning shares in a company				
Intra-company disputes in respect of a Russian company				
Can submit to arbitration	*All shareholders and company are parties*	*Seat of arbitration in Russia*	*Administered by a licensed arbitral institution*	*Special rules for corporate disputes apply*
• formation, reorganization or liquidation of a company • derivative actions brought by shareholders of a company • claims by a company against its directors or internal auditors • shareholder agreements • issuance of securities of a company • challenges to a company's internal resolutions • any other disputes that arise between a company and its shareholders				

CHART 2
NON-ARBITRABLE DISPUTES IN RUSSIA

Non-business disputes

- family disputes other than division of marital assets
- probate proceedings
- eviction from residential housing
- special proceedings to establish legal facts (e.g., declaration of death, paternity, etc.)
- compensation for loss of life or harm to health
- labor disputes
- consumer claims against Forex-dealers

Public law disputes

- annulment of acts or decisions of public authorities
- registration of companies and sole traders
- administrative offences
- recovery of taxes and levies
- compensation for delay in judicial proceedings
- government and municipal procurement of goods and services under federal contract system (planned to become arbitrable in the future)
- privatization disputes
- environmental damage claims

Group actions (where only some of the claimants are named)

Insolvency (bankruptcy) proceedings

Certain intellectual property disputes

- disputes involving collective rights management organizations
- grant and seizure of protection of intellectual property rights by the state
- patent holder contests
- annulment of patents