

# International Law Practicum

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## Practicing the Law of the World from New York

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# An Introduction to Enforcement in Russia of Foreign Arbitral Awards, and Barriers to Entry to American Courts

By Daniel J. Rothstein

## I. Introduction

Since the large-scale entry of foreign businesses into the Russian market in the early 1990s, the normal practice for foreign parties to international business deals in Russia has been to provide, when possible, for dispute resolution to take place outside of Russia and to be governed by other than Russian law. The main reasons for this are fears that Russian commercial law is undeveloped, and that Russian legal institutions are inexperienced in commercial matters, biased in favor of local parties, susceptible to political influence, or corrupt.<sup>1</sup>

In recent years, a similar trend has emerged among Russian businesses, i.e., entities owned by Russian citizens. Russian participants often prefer dispute resolution forums outside of Russia<sup>2</sup> because of the same fears of unpredictability mentioned above. Other factors that have moved many Russian disputes abroad include (i) Russian citizens' frequent use of foreign companies in order to hold Russia-based assets for tax reasons or to shield the ultimate owners' identity from competitors or the public;<sup>3</sup> and (ii) the involvement of foreign lenders and foreign law firms in many significant transactions among Russian parties.

Because of Russia's explosive economic growth in recent years, the number of Russia-related disputes decided abroad has also grown rapidly. This trend has begun to attract considerable attention from lawyers specializing in international dispute resolution. For example, the cover story of the April 2008 issue of *Global Arbitration Review* was devoted to Russia.<sup>4</sup>

The following discussion will introduce two main points of intersection between the Russian legal system and non-Russian forums (in particular the United States) regarding predominantly Russian commercial disputes: (i) enforcement in Russia of foreign court judgments and arbitral awards; and (ii) jurisdictional and similar barriers to entry to courts in the United States.

## II. Enforcement in Russia

### A. Enforcement in Russia of Foreign Court Judgments

Under Russian legislation, foreign court judgments can be enforced in Russia only if a treaty so provides. As of 2007, Russia had such treaties with only thirty-six countries, including ten members of the Commonwealth of Independent States. However, in some recent cases,

even in the absence of a treaty, Russian courts have enforced foreign court judgments under the international law principle of comity. It has been argued that there is little legal basis for using this general norm to support enforcement of a foreign court order.<sup>5</sup> Thus, there are no grounds for confidence that a court judgment from a non-treaty country will be enforced in Russia.

### B. Enforcement in Russia of Foreign Arbitral Awards

Russia is a member of the 1958 New York Convention on Recognition and Enforcement of Arbitral Awards by virtue of the USSR's accession to the Convention in 1960 and post-Soviet Russia's assumption of the USSR's international treaty rights and obligations. In 2002, the Russian courts with jurisdiction over most commercial disputes, called the "state arbitrazh courts," were given responsibility for enforcement of international arbitration awards. The state arbitrazh courts' treatment of requests to enforce international arbitral awards has given rise to considerable controversy in recent years, in particular in connection with (1) the application of public policy grounds for non-enforcement of awards, and (2) the exclusion of major areas of commercial law from arbitral competence, in particular in cases involving non-Russian parties.<sup>6</sup>

#### 1. Non-Enforcement of Arbitral Awards on Public Policy Grounds

The most authoritative and comprehensive source of guidance on enforcement of arbitral awards in Russia is the Supreme Arbitrazh Court's *Information Letter No. 96*, issued in December 2005. The Letter consists of summaries and comments on thirty-one cases decided by the arbitrazh courts of various levels, including the Supreme Arbitrazh Court itself, and recommendations to lower courts on deciding future cases.<sup>7</sup> According to one commentator, the choice of cases selected for review, and the manner of presenting them (for example, tendentious presentation of facts in some instances), reveal the Supreme Arbitrazh Court's ambivalence and inconsistency in enforcing international arbitral awards and a greater reluctance to enforce than in the lower courts with the most experience in the area—the courts in Moscow and St. Petersburg.<sup>8</sup>

One case in particular from the Supreme Arbitrazh Court's survey illustrates the Court's strong interventionist tendency and its elastic view of public policy grounds for non-enforcement. In that case, presented in Section 29 of the Court's *Information Letter No. 96*, the arbitration

award provided that a Russian joint venture and one of its founders (apparently also a Russian entity) should pay \$20 million to a foreign founder in connection with its withdrawal from the joint venture. The \$20 million represented the value of the foreign partner's contribution to the joint venture's charter capital. The Supreme Arbitrazh Court denied enforcement, and noted that the arbitral tribunal's award did not take into consideration the fact that the charter capital contribution, in the form of equipment, had not been imported to Russia by the time the award was rendered. The Supreme Arbitrazh Court remanded the case to the lower court with instructions to consider, among other issues, whether public policy is consistent with "the possibility of returning to a founder its property contribution to the charter capital of a joint venture . . . while also imposing damages in the form of the contribution upon the joint venture itself, as well as one of its founders." The Supreme Arbitrazh Court further instructed the lower court to examine this issue with consideration for "the litigants' equal right to judicial protection." On remand, the lower court refused enforcement, because, as the Supreme Arbitrazh Court reported, the award contradicted Russian public policy, which is "based on the principles of equality of parties to civil-law relations, their good-faith behavior, and the proportionality of civil-law liability to the effects of the breach of duty, taking into account fault."<sup>9</sup>

The Supreme Arbitrazh Court's discussion of this case, which is only three pages long, does not consider how the arbitral award could be justified (for example, the foreign party's position on the asserted deficiencies in the award). Thus, it is difficult to evaluate whether the arbitration award was incorrect under the law governing the arbitration, and, assuming the award was incorrect under the governing law, how the Supreme Arbitrazh Court distinguishes between an award that is incorrect and one that violates Russian public policy. Moreover, as the commentator referred to above points out, the Supreme Arbitrazh Court's imposition of "equality of parties to civil law relations, their good-faith behavior, and proportionality of civil law liability" as guidelines for applying the public policy exception creates wide possibilities, inconsistent with international norms, for substantive review of arbitral decisions.<sup>10</sup>

More recently, another commentator has asserted that "there is no evidence that this 'broad' term in approach to the public policy issue [as presented in Section 29 of *Information Letter No. 96*] has been followed by judges, including at the level of the Supreme Arbitrazh Court. Indeed in several recent cases the Supreme Arbitrazh Court has adopted a narrower interpretation for the public policy ground."<sup>11</sup> In one case cited by this commentator, *Joy-Lud Distributors International Inc. v. JSC Moscow Oil Refinery*, the Supreme Arbitrazh Court ruled, in two decisions in 2006 and 2008, that a \$28 million contractual penalty award in favor of Joy-Lud (a New York corpora-

tion) in a Stockholm arbitration under Swedish law did not violate Russian public policy. A review of the *Joy-Lud* decisions, however, suggests a less arbitration-friendly stance than that commentator discerns.

In the 2006 decision in *Joy-Lud*, the Supreme Arbitrazh Court rejected the Russian party's argument that the award violated public policy because it was improperly punitive. One of the Court's primary grounds for rejecting this argument was that Russian law allowed for the same kind of penalty as the arbitral tribunal had granted under Swedish law. Thus, the Court stated, citing Section 29 of its *Information Letter No. 96*:

[Russian] civil law proceeds from the principle of equal rights and obligations of Russian and foreign legal and physical persons and contemplates imposition of a penalty as a possible measure of liability for nonperformance or inadequate performance of contractual obligations. Therefore, this measure is part of the legal system of the Russian Federation, and its imposition does not violate the public policy of the Russian Federation.<sup>12</sup>

The Court also noted that the penalty was not disproportionate to the effects of the breach.<sup>13</sup>

In the 2008 decision in the same case, the Russian party argued that it had new evidence that the claimant had misrepresented its identity to the arbitrators and the courts. Thus, the Russian party argued that enforcement of the award, resulting in enrichment of an entity that was not a party to the transaction, would violate public policy. The Supreme Arbitrazh Court rejected the assertion that the evidence was new, and pointed out that it could have been presented to the Stockholm arbitration tribunal. But the Court also evaluated the evidence presented by the Russian party—that various documents referred to the claimant alternatively as "Joy-Lud" and "Joy Lud" (i.e., with and without a hyphen). On the basis of other evidence, including a declaration from the New York company registration authorities, the Supreme Arbitrazh Court found that Joy-Lud and Joy Lud were one and the same company.<sup>14</sup>

Although the Supreme Arbitrazh Court ultimately upheld the arbitral award in *Joy-Lud*, the Court's repeated, in-depth examination of the substance of the award does not send a clearly pro-arbitration message. In its 2006 decision, the Court's reliance on the similarity between Swedish and Russian law governing contractual penalties raises a question as to whether the Court would have refused to enforce the award on public policy grounds (i) if Swedish and Russian law were not similar, or (ii) if the Court had considered the penalty disproportionate to the breach of contract. (As noted above, the Court found the penalty proportionate.) Also, the 2006 decision's reference

to the equality of Russian and foreign litigants sounds gratuitous, creating the impression that upholding an award for a foreign party is an important occasion, and by implication perhaps an exception.

Similarly, in the 2008 decision, after the Supreme Arbitrazh Court ruled that the Russian party could have presented the evidence of confusion of Joy-Lud's identity to the arbitrators, the discussion of whether there was confusion was unnecessary. Even if the arbitrators had seen the evidence and wrongly concluded that there was no confusion, this would hardly be grounds for invoking the public policy exception. As in the joint venture withdrawal case in Section 29 of *Information Letter No. 96*, the Supreme Arbitrazh Court did not explain the distinction between an erroneous arbitral award and one that violates public policy. Thus, the *Joy-Lud* decisions blur the distinction between error and a violation of public policy, and leave wide room for invoking the public policy exception in future cases.

## 2. Exclusion of Subject Matter from Arbitral Jurisdiction

Under Russia's Law on International Arbitration, the subject matter of international commercial arbitration is limited to "disputes resulting from contractual and other civil law relations."<sup>15</sup> Russia's law on domestic arbitration contains a similar limitation.<sup>16</sup> Also, Article 248 of the Arbitrazh Procedure Code reserves certain disputes involving foreign parties for the "exclusive jurisdiction" of the state arbitrazh courts, including disputes involving real property located in Russia.<sup>17</sup>

The Supreme Arbitrazh Court has interpreted these provisions as excluding disputes over real estate rights from arbitral jurisdiction. For example, *Information Letter No. 96* discussed a domestic arbitral award that upheld the claimant's contractual right to purchase a building. Specifically, the award "recognized the [claimant's] ownership right" and "required the state registration agency to register that right." The claimant's application to enforce the award was denied, because replacing the owner of real estate in the state registry is a matter of "public and administrative law relations," and thus not the subject of "contractual and other civil law relationships," which are the only permissible subject matter of arbitration, as noted above.<sup>18</sup> In a later case that applied these Supreme Arbitrazh Court guidelines and likewise held that a dispute over real estate rights was beyond arbitral jurisdiction, an intermediate-level appeals court rejected without explanation the argument that the arbitral award required only the parties, not the state registration agency, to take action, i.e., to submit a lease extension agreement to the agency.<sup>19</sup>

Similarly, in another case discussed in *Information Letter No. 96*, the prevailing party was a foreign company, and the arbitral award in its favor included money dam-

ages, but also a levy on a building at a price provided for in the award. The Supreme Arbitrazh Court set aside the arbitral award insofar as it concerned the rights to the building. The Court noted that one of the parties was a foreign entity, and upheld the lower court's holding that under Article 248 of the Arbitrazh Procedure Code, the claim involving real estate "could not be reviewed by the arbitral tribunal."<sup>20</sup>

In a recent case involving a lease of a prime Moscow retail site, the state arbitrazh court set aside an award rendered by the International Commercial Arbitration Court at the Russian Federation Chamber of Commerce and Industry. The claimant, a Russian subsidiary of the Finnish department store chain Stockmann, obtained an arbitral award requiring its landlord to renew the lease or pay damages of \$27 million. The court set aside the award, because lease rights are established by registration of a lease agreement with the state registration agency, and the issue of whether such rights should be registered is a matter of "public and administrative law relations" and cannot be the subject of arbitral jurisdiction.<sup>21</sup>

A controversial question in Russia is whether a foreign choice of law or forum clause in a shareholders' agreement concerning the operation of a Russian company is valid. In one case involving a contest for control of a major Russian telecommunications company, an appellate court held that a provision in a shareholders' agreement, which called for foreign arbitration under foreign law of challenges to corporate decisions, was invalid. An editorial note in Russia's leading international arbitration periodical agreed with the court's decision, while disagreeing with the court's "public policy" basis for the decision. The editorial note stated that shareholder agreements concerning Russian companies must be governed only by Russian law, and suggested that shareholders in Russian companies should not be "led astray by lawyers in international law firms, who prefer to subject their clients' agreements not to Russian law, but to foreign law, with which they are more familiar."<sup>22</sup> The parties in the telecommunications dispute who challenged the choice of law and forum clause relied on various provisions of Russian corporate, civil, and constitutional law.<sup>23</sup> Parties taking this position could also cite Article 248 of the Arbitrazh Procedure Code, which provides that the state arbitrazh courts have "exclusive jurisdiction" over disputes connected with "the foundation, liquidation, or registration in the Russian Federation of legal entities," and with "challenging the decisions of organs of such legal entities."<sup>24</sup>

Russian law's ambivalence toward international arbitration has been attributed in part to "the short time that has passed since our country rejected a policy of isolationism" and also to a traditional suspicion of a "conspiracy of the West against Russia."<sup>25</sup> Suspicion toward international arbitration is most clearly misplaced when both sides to the dispute are Russian-owned companies. As

