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Arbitration in Russia in tough economic times

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Is it still an option for European suppliers?

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Europe and Russia – politically apart but economically interdependent

Although relations between Europe and Russia have become increasingly strained in the last couple of years, and commerce has been affected by sanctions and other restrictions, Russia is and will remain an important market for German and other European companies. Russia continues to need and prefer high-quality European goods and services, and Europe needs Russia's natural resources. Just how dependent Europe is on Russian natural resources became abundantly clear last month when the US sanctioned Rusal, one of the world's

largest aluminum producers, sending shockwaves across European supply chains (in particular in the German automotive industry) until a temporary solution was found after significant European lobbying efforts in Washington.

Dispute resolution in a neutral third country has traditionally been the norm between Europe and Russia

The extensive economic ties between Europe and Russia have obviously resulted in a vast number of contracts between European and Russian companies. When contracting with their Russian counterparts, most European (including German) companies have sought to avoid disputes under contracts settled in Russia, be it through Russian state court proceedings or arbitral proceedings seated in Russia. This is partially based on concerns (sometimes unjust) about the perceived lack of independence and integrity of the Russian judiciary, but also consistent with a general preference in international commerce to avoid dispute resolution in the jurisdiction of the counterparty. Many Russian companies have also been willing to agree to dispute resolution by arbitration in a third country. As a result, a high proportion of commercial disputes between European and Russian companies have been resolved outside of Russia, typically through international arbitration in a third country.

When dispute resolution in Russia is the only alternative

That is not to say that there are no contracts between European and Russian companies that provide for dispute resolution in Russia. There is undoubtedly a significant number of such contracts and a multitude of reasons why European companies have agreed to dispute resolution in Russia. One reason is that the Russian counterparty simply has more leverage in the negotiations and the European company must agree to dispute resolution in Russia to have any chance of securing an attractive deal. For example, it is not uncommon for tenders announced by Russian state-owned companies to require the successful bidder to accept dispute resolution in Russia. Another reason can be that the European company is conducting its business in Russia through a Russian subsidiary and it may therefore be difficult in practice to insist on dispute resolution outside of Russia in what, formally speaking, is a purely Russian affair. A third reason could simply be that the European company views dispute resolution in Russia as the best solution since the counterparty only has assets in Russia and any enforcement would need to take place in that jurisdiction in any event.

The license requirement for institutional arbitration

Whatever the reason for agreeing to dispute resolution in Russia, European companies with existing contracts providing for arbitration in Russia, or those that may be faced with such a choice in the future, need to carefully consider the far-reaching implications of the recent Russian arbitration reform.

In 2016, a number of changes to Russia's arbitration laws came into effect with the stated intent of increasing the use of arbitration in Russia. Among other things, a licensing regime for arbitration institutions administering arbitrations seated in Russia (permanent arbitration institutions) was introduced, and such institutions were given certain advantages.

These specific changes were said to be intended to deal with concerns about 'pocket arbitrations'. Pocket arbitration refers to arbitration institutions not seen as independent (of which there were hundreds prior to the reform). As further discussed below, it remains uncertain whether the reforms will make arbitration in Russia more attractive. Early signs indicate that the Ministry of Justice of the Russian Federation, which decides on licenses based on applications from arbitration institutions, has adopted a strict interpretation of the requirements to grant such licenses, effectively excluding a large number of credible arbitration institutions from administering arbitrations seated in Russia.

Two established Russian arbitration institutions dating back to Soviet days and tied to the Russian Chamber of Commerce and Industry are exempt from the licensing requirement: The International Commercial Arbitration Court (ICAC) and the Maritime Arbitration Commission (MAC). To date, only two arbitration institutions have been granted a license by the Russian Ministry of Justice: The Arbitration Court of the Russian Union of Industrialists and Entrepreneurs (RSPP) and the Arbitration Center at the Institute of Modern Arbitration (IMA). Thus, as of now, there are only four arbitration institutions that are entitled to operate as permanent arbitration institutions in Russia.

Although there are no publicly available official data on the number of applications for licenses that have been rejected by the Russian Ministry of Justice, reports suggest several hundred that include not only the Russian Arbitration Association, but also several well-regarded non-Russian arbitration institutions. Also, several established international arbitration institutions with a strong position with respect to Russia-related disputes, including the Stockholm Chamber of Commerce (SCC) and the International Chamber of Commerce (ICC), have decided not to apply for registration, no doubt in part due to the formalistic and administratively burdensome registration requirements.

Effects on existing and future arbitration clauses

So, what are the possible implications for arbitration clauses in existing and future contracts providing for arbitration seated in Russia under the rules of an arbitration institution which has not been licensed by the Russian Ministry of Justice as a permanent arbitration institution?

Formally speaking, the Russian arbitration reform does not mean that arbitration clauses providing for arbitration in Russia under the rules of an unlicensed arbitration institution are invalid per se. Rather, the approach taken under Russian arbitration law is that arbitrations administered by unlicensed arbitration institutions are viewed as ad hoc arbitrations and denied certain advantages granted to licensed arbitration institutions. These include the potentially important right to apply to the Russian courts for judicial assistance on certain procedural issues, including the appointment, challenge and termination of the mandate of arbitrators, and to obtain evidence in Russia.

However, at this time, no one really knows how Russian courts will treat arbitration clauses providing for arbitration in Russia under the rules of unlicensed arbitration institutions or awards issued by tribunals under such rules. It cannot be ruled out that such clauses and/or awards will be viewed as pathological and thus be difficult to enforce.

The need to review arbitration clauses providing for arbitration in Russia

The potential enforcement difficulties, along with the known disadvantages of nonregistration, such as the absence of judicial assistance, means that European companies have every reason to avoid arbitration clauses providing for arbitration in Russia under the rules of unlicensed arbitration institutions, or, if applicable, seek to amend existing clauses.

In principle, they have two options: Either they can seek to avoid arbitration seated in Russia altogether (and instead insist on dispute resolution outside of Russia, for example SCC arbitration in Stockholm or ICC arbitration in Paris), or

they can make sure that their arbitration clauses refer to arbitration in Russia under the rules of one of the arbitration institutions (currently ICAC, MAC, RSPP and IMA) that have been licensed by the Russian Ministry of Justice. A third option could be to consider agreeing to have disputes under their contracts resolved by the Russian state courts.

Each alternative has its own pros and cons but the first option (dispute resolution outside of Russia in an established jurisdiction for international arbitration) remains the safest bet for European companies, in particular when it comes to key contracts.

Either way, the first step for European companies is to be aware of the Russian arbitration reform and to thoroughly review their existing contracts to determine to what extent, if any, the arbitration clauses therein need to be amended. European companies should also monitor whether the Russian Ministry of Justice grants any additional licenses. One organization with European roots which hopes to be granted a license as a permanent arbitration institution in Russia is the Arbitration Court of the Association of European Businesses in Russia. This Association was founded in 1995 and is the main organization representing European companies in Russia.

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2 replies on “Arbitration in Russia in tough economic times”

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