CHANGES IN REGULATION OF ARBITRATION IN RUSSIA

On 29 March 2019, Federal Law No. 531-FZ of 27 December 2018 On the Incorporation of Amendments to the Federal Law On Arbitration in the Russian Federation and to the Federal Law On Advertising (the "**Amending Law**") will take effect.

The Amending Law includes a range of amendments to Federal Law No. 382-FZ of 29 December 2015 On Arbitration in the Russian Federation (the "**Arbitration Law**"), which itself was enacted as part of the so-called "arbitration reform"[1]. These amendments include the following:

- the procedure for authorisation to administer arbitration as a permanent arbitral institution ("**PAI**") is changed;
- it is stipulated that for disputes arising out of agreements of participants of a legal entity regarding the management of that legal entity, including disputes arising out of corporate agreements and disputes involving invalidation of transactions of a legal entity at the request of its participants, to be arbitrable it is sufficient for there to be an arbitration agreement in place between the parties to the relevant agreement or transaction;
- disputes arising out of corporate agreements are arbitrable as long as arbitration will be administered by a PAI, even if the institution in question does not have rules governing the arbitration of corporate disputes; and
- it is stipulated that disputes arising out of agreements entered into under or in connection with Federal Law No. 223-FZ of 18 July 2011 On Procurements of Goods, Works and Services by Certain Types of Legal Entities (the "**Procurements Law**") are arbitrable.

Key Provisions

- The procedure for authorisation to administer arbitration as a permanent arbitral institution is changed
- Simplified requirements applicable to arbitration clauses governing disputes arising out of corporate agreements and legal actions brought by the participants of a company in the company's interests
- However, there are inconsistencies between the new law and currently applicable regulation
- Many of the restrictions that arose as a result of the "arbitration reform" of 2015 remain

The Amending Law is intended to somewhat ease the restrictions established by the Arbitration Law and impart more certainty to the practice of its application. However, in our view many of the questions that arose in connection with enactment of the Arbitration Law remain unresolved.

[1] See also Federal Law No. 409-FZ of 29 December 2015 On the Incorporation of Amendments to Certain Legislative Acts of the Russian Federation and Declaring Inoperative Article 6(1)(3) of the Federal Law On Self-Regulated Organisations in Connection with Enactment of the Federal Law On Arbitration in the Russian Federation.

PERMANENT ARBITRAL INSTITUTIONS

OVERVIEW OF THE ARBITRATION REFORM OF LATE 2015

As we have written earlier[2], the arbitration reform introduced the concept of a PAI, i.e. a subdivision of a non-profit organisation administering arbitration on a permanent basis. Foreign arbitral institutions can also be conferred the status of a PAI.

To obtain the status of a PAI:

- The organisation must submit to the Ministry of Justice of the RF (the "**Ministry of Justice**") the application and appendices set out in Order of the Ministry of Justice No. 165 of 13 July 2016 On the Council for the Advancement of Arbitration ("**Order No. 165**").
- The initial review of the documents is arranged by the secretary of the Council for the Advancement of Arbitration (the "**Council**") in conjunction with officials from the Ministry of Justice and with the involvement of specialists by decision of the chairman of the Council or (upon his/her instruction) the deputy chairman of the Council.
- Further, the Council considers the applications and appendices which have been filed and takes a decision as to whether applicant organisation meets the requirements set out in the Arbitration Law.
- According to the previous wording of the Arbitration Law, the only requirement foreign arbitral institutions must meet is that they be "*of widely recognized international repute*".
- Should the Council find that an organisation meets the requirements established by the Arbitration Law, the Council issues a recommendation to the Government of the RF to authorise the organisation to administer arbitration as a PAI. The right to administer arbitration as a PAI is granted in the form of an act of the Government of the RF.

Accordingly, as a result of the arbitration reform organisations must go through a complex bureaucratic process to be authorised to administer arbitration. In practice, in the course of that process most applications are rejected for various reasons. To date, not a single foreign arbitral institution has been granted the status of a PAI.

THE AMENDMENTS

The contemplated amendments do not significantly change the bureaucratic process established by the Arbitration Law:

- An exhaustive list of the documents that must be submitted as appendices to the application for authorisation to administer arbitration as a PAI is now set out directly in the Arbitration Law rather than in Order No. 165.
- At the Council's recommendation, the Ministry of Justice must specify the criteria to be used by the Council in determining whether a foreign arbitral institution is "*of widely recognized international repute*"[3]. The Ministry of Justice must draft an order approving such criteria within 3 months after the enactment of the Amending Law (i.e. until the end of March 2019).
- Initially, when the draft Amending Law was first submitted to the State Duma of the RF, it was contemplated that in order to be eligible to be granted the status of a PAI a foreign arbitral institution would have to establish a "*separate division*" in Russia to administer any disputes: the authors of the draft law (mainly officials of the Ministry of Justice) believed this would help ensure that only those foreign arbitral institutions that have proved the seriousness of their intention to work in Russia would be granted authorisation[4]. But in its final version the

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[2] See our client briefing from August 2016, available on our website (https://www.cliffordchance.com/briefings/2016/08/new_regulation_ofarbitrationintherussia0.html).

[3] See Article 44(12)(1) of the Arbitration Law as amended by the Amending Law.

[4] According to comments made by deputy minister of justice of the RF D.V. Novak in the State Duma of the RF on 5 April 2018 (http://sozd.parliament.gov.ru/bill/350176-7).

Amending Law stipulates that the requirement to create a separate division in Russia applies only in cases where a foreign arbitral institution intends to administer arbitration of domestic disputes[5].

- The right to administer arbitration as a PAI will now be granted in the form of an act of the Ministry of Justice rather than the Government of the RF.

Hence with the enactment of the Amending Law the complex bureaucratic process set out in the Arbitration Law has undergone some minor changes, but at its core remains essentially the same. Despite the popularity of foreign arbitral institutions[6] and their general reputability among practitioners, the legislation does not envisage the possibility of granting foreign arbitral institutions the status of a PAI by decision of the Council without going through the procedure described above, or automatically (as was done, for example, for the International Commercial Arbitration Court at the Chamber of Commerce and Industry of the RF). Undoubtedly, this does not serve to advance the development of arbitration in Russia.

ARBITRABILITY OF CORPORATE DISPUTES

OVERVIEW OF THE ARBITRATION REFORM OF LATE 2015

As a result of the arbitration reform, significant changes were made to the regulation of arbitration of corporate disputes (i.e. disputes related to the establishment or management of a legal entity or participation in a legal entity). Article 225.1 of the Arbitrazh Procedure Code of the RF divides corporate disputes into three categories, based on arbitrability:

- Corporate disputes that are not arbitrable ("**Category 1**"). Category 1 includes disputes relating to:
  - refusal to register a legal entity;
  - convocation of general meetings of participants of a legal entity;
  - purchase and buy-back of shares by a joint-stock company;
  - compulsory offers to purchase shares;
  - exclusion of participants from legal entities;
  - the activities of public notaries involving certification of transactions with stakes in the charter capital of limited liability companies; and
  - many disputes involving business entities of strategic importance for national defence and state security[7].
- Corporate disputes that are arbitrable only if all of the following four conditions are met ("**Category 2**"):
  - arbitration of the dispute must be administered by a PAI;
  - the dispute must be heard according to special rules of procedure applicable to corporate disputes;
  - the arbitration must be seated in Russia;
  - the legal entity itself, all of its participants, and any other persons acting as claimants or defendants must be parties to the arbitration agreement.

  Category 2 includes disputes associated with:
  - shareholder agreements relating to the management of a legal entity, including disputes arising out of corporate agreements; and

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5 With the exception of disputes between participants in a special administrative district, the legal regime applicable to which is defined by Federal Law No. 291-FZ of 3 August 2018 On Special Administrative Districts in the Kaliningrad Region and the Primorsk Territory, and disputes arising out of agreements on activities conducted in the territory of a special administrative district.

6 Such as the London Court of International Arbitration, the International Court of Arbitration of the International Chamber of Commerce, the Arbitration Institute of the Stockholm Chamber of Commerce, the Singapore International Arbitration Centre, and many others.

7 In accordance with Federal Law No. 57-FZ of 29 April 2008 On the Procedure for Making Foreign Investments in Business Entities of Strategic Importance for National Defence and State Security.

  - disputes involving claims of participants of a legal entity seeking compensation of losses, invalidation of transactions performed by the legal entity, and application of the consequences of their invalidity.

- Corporate disputes, the only requirement applicable to which is that they must be administered by a permanent arbitral institution ("**Category 3**"). Category 3 includes disputes associated with:
  - the ownership of shares or participation interests in Russian companies, the establishment of encumbrances over them and the exercise of the rights conferred by them (including, among other things, disputes associated with agreements on sale and purchase of shares or participation interests and enforced recovery against them); and
  - the recording of shares and other securities by registrars.

In some cases this regulation may enable arbitration agreements involving Russian companies to be circumvented. For example, in a situation where a Russian company has entered into a contract with a counterparty containing an arbitration agreement, disputes involving a legal action initiated by a participant of the company to have the contract declared invalid (void) may be held to be Category 2 corporate disputes[8]. For instance, participants in a company (shareholders, etc.) can file a claim for invalidation of a contract on the grounds that the necessary corporate approvals were not obtained, or that the contract was entered into "*to the detriment of the legal entity's interests*"[9], or that in entering into the contract an abuse of rights was committed[10]. Accordingly, for such disputes to be arbitrable the company itself, all of its participants and its counterparty under the contract must be parties to the arbitration agreement. However, in practice the parties to an arbitration agreement in a contract between a Russian company and its counterparty are usually only the company itself and that counterparty. Therefore, the participants of a Russian company can be held to be not bound by the arbitration agreement in a contract between the Russian company and its counterparty, in which case they can be free to initiate proceedings at the place where the Russian company is located, i.e. in a Russian court, not in arbitration. If the Russian court were to render a decision declaring the contract invalid, this could prevent enforcement of an arbitral award in Russia.

This problem relates not only to disputes over participation interests or shares, but in principle to any transaction performed with the involvement of a Russian commercial entity[11].

THE AMENDMENTS

The new Article 7(7.1) of the Arbitration Law states "[f]*or disputes arising out of agreements of participants of a legal entity regarding the management of that legal entity, including disputes arising out of corporate agreements, and disputes involving claims for invalidation of transactions of a legal entity filed by its participants and/or for application of the consequences of the invalidity of such transactions to be arbitrable, it is sufficient for there to be an arbitration agreement in place between the parties to the relevant agreement of the participants of the legal entity or transaction*".

Article 45 (7.1) of the Arbitration Law states "[t]*he disputes referred to in sections 2 and 6 of Article 225.1(1) of the Arbitrazh Procedure Code of the Russian Federation and disputes arising out of agreements of participants of a legal entity regarding the management of that legal entity, including disputes arising out of corporate agreements, may be*

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8 The right of a corporation's participants to challenge transactions performed "*on behalf of the corporation*" is enshrined in Article 65.2(1) of the Civil Code of the RF. However, as follows from Article 225.1(1)(3) of the Arbitrazh Procedure Code of the RF (the "**APC of the RF**"), Category 2 disputes include disputes involving invalidation of transactions performed by a legal entity "*based on claims brought by the founders, participants or members of the legal entity*", without stipulating that in such disputes those participants are acting on behalf of the corporation. Thus, the Russian courts have been called upon to resolve the issue as to whether a claim filed by a participant on behalf of a corporation, seeking to invalidate a transaction performed by that corporation is a "corporate dispute" (within the meaning of Article 225.1 of the APC of the RF) or not. In some judicial acts an affirmative answer has been given: see decree of the Arbitrazh Court of the North-West District No. F07-10735/2018 dated 23 August 2018 in case No. A56-26731/2018; decree of the Arbitrazh Court of the North Caucasus District No. F08-323/2017 dated 20 February 2017 in case No. A32-28364/2015.

9 Article 174(2) of the Civil Code of the RF (the "**CC of the RF**").

10 See para. 7 of Decree of the Plenum of the Supreme Court of the Russian Federation No. 25 dated 23 June 2015 On Application by the Courts of Certain Provisions of Section I Part One of the Civil Code of the Russian Federation.

11 And also non-profit organisations of the types specified in Article 225.1(1) of the APC of the RF.

heard through arbitration administered by a permanent arbitral institution, in the absence of rules on arbitration of corporate disputes".

As concerns disputes involving claims of participants of a company for invalidation of transactions (such as contracts) performed by a legal entity and/or application of the consequences of the invalidity of such transactions, neither the Amending Law nor any other draft laws have amended Article 225.1 of the APC of the RF, which continues to envisage that disputes involving such claims of participants fall under Category 2 (i.e. for the participants of a company to be bound by an arbitration clause to which that company is a party, the arbitration clause must meet the four Category 2 conditions described above). In our view, the resulting regulatory treatment could be interpreted in at least two alternative ways:

- for disputes involving such claims of participants to be referred to arbitration a regular arbitration clause between the parties to the transaction is sufficient (for example, if two companies enter into a goods supply contract containing an arbitration clause, a company participant will be bound by the arbitration clause even if the clause does not stipulate that disputes are to be referred to a PAI and the company participant is not a party to the arbitration clause); or
- for disputes involving such claims of participants to be referred to arbitration it is necessary that (a) the dispute be administered by a PAI, (b) the dispute be heard in accordance with the specific rules of procedure governing corporate disputes, and (c) the arbitration be seated in Russia.

Further to the above, it should be noted that Russian law allows to bring claims for invalidation of a transaction performed by the corporation not only to the participants of a corporation, but also to the members of its board of directors (supervisory board)[12], who might not be participants of the corporation. However, based on the literal meaning of the amendments, they do not apply to claims of members of the board of directors (supervisory board). The Amending Law does not resolve the question of whether a member of the board of directors (supervisory board) of a corporation must be a party to the arbitration agreement in order for claims filed by him/her for invalidation of a transaction of the company to be subject to the arbitration agreement in the transaction.

The Amending Law also does not contain any provisions clarifying whether an arbitration agreement in a contract concluded by a company before the Amending Law takes effect will be binding upon a company participant who files a claim for invalidation of a transaction of the company after the Amending Law has become effective. In other words, it remains open to question which rules – the old (more conservative) or the new (more liberal) ones – should apply to arbitration agreements concluded prior to the entry into force of the Amending Law.

As regards disputes involving claims arising out of corporate agreements, the Amending Law also creates uncertainty, because Article 225.1 of the APC of the RF has not been amended. Again, here the resulting regulatory treatment can be interpreted in at least two ways:

- for disputes involving claims arising out of corporate agreements to be arbitrable it is now sufficient that the corporate agreement contain an arbitration clause in favour of a PAI; or
- for disputes involving claims arising out of corporate agreements to be arbitrable it is necessary not only that (a) the corporate agreement contain an arbitration clause in favour of a PAI, but also that (b) the arbitration be seated in Russia.

Therefore, despite the attempt to ease regulation, there remain risks associated with uncertainty as to the substance of the amendments, their effect in time, and the possibility of circumvention of arbitration clauses.

[12] Article 65.3(4) of the CC of the RF.

DISPUTES ARISING OUT OF CONTRACTS ENTERED INTO UNDER OR IN CONNECTION WITH THE PROCUREMENTS LAW

CURRENT REGULATION

The APC of the RF sets out a list of disputes that are non-arbitrable and stipulates that the non-arbitrability of a dispute must be explicitly established by law[13]. At the same time, neither the APC of the RF nor other laws prohibit disputes arising out of contracts entered into in accordance with the Procurements Law from being referred to arbitration[14] (as opposed to disputes arising out of a procurement contract under which an order is made directly by the state: non-arbitrability of such disputes is explicitly established by the APC of the RF).

Yet the case law addressing the issue of whether disputes arising out of contracts entered into in accordance with the Procurements Law are arbitrable or not is contradictory[15]. Recently the courts have exhibited a somewhat greater tendency to hold such disputes to be non-arbitrable[16].

THE AMENDMENTS

The amendments made to the Arbitration Law envisage that disputes arising out of contracts entered into under or in connection with the Procurements Law are arbitrable. As follows from the new Article 45(10) of the Arbitration Law, "[i]*f the arbitration is seated in the Russian Federation*", then such disputes "*can be heard only in arbitration administered by* [a PAI]".

However, from this wording it remains unclear whether such disputes can be referred to arbitration venued outside Russia and administered by a foreign arbitral institution that does not have the status of a PAI. In particular, the above wording could mean that

- disputes arising out of the Procurements Law are arbitrable, but only if (a) the arbitration is seated in Russia, and (b) the arbitration will be administered by a PAI; or
- disputes arising out of the Procurements Law are arbitrable even if the arbitration is seated outside Russia; however if the arbitration is seated in Russia, then it must be administered by a PAI and cannot be heard by an *ad hoc* arbitral tribunal.

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13 Article 33 of the APC of the RF.

14 This law applies, in particular, to transactions entered into by state companies, state corporations, public-law companies, natural monopolies, etc.

15 Ruling of the Supreme Court of the RF No. 310-ES16-11375 dated 19 September 2016; ruling of the Supreme Court of the RF No. 309-ES16-1489 dated 30 March 2016; ruling of the Supreme Court of the RF No. 305-ES17-1969 dated 20 March 2017.

16 Ruling of the Supreme Court of the RF No. 305-ES17-7240 dated 11 July 2018.

CLIFFORD CHANCE

CONTACTS

Timur Aitkulov
Partner*

T +7 499 270 3055
E timur.aitkulov@cliffordchance.com

Dmitry Malukevich
Senior Associate

T +7 495 660 8072
E dmitry.malukevich@cliffordchance.com

Alexey Vyalkov
Associate

T +7 495 660 8031
E alexey.vyalkov@cliffordchance.com

* Private legal practice of T. D. Aitkulov in co-operation with Clifford Chance

www.cliffordchance.com

Clifford Chance, Ul. Gasheka 6, 125047 Moscow, Russia