ALERT MEMORANDUM

Changes to Russia's Arbitration Law Will Come Into Effect on 29 March 2019

March 29, 2019

On 29 March 2019, the amendments to Federal Law No. 382-FZ "On Arbitration (Arbitration Proceedings) in the Russian Federation" (the "**Arbitration Law**") will come into force (the "**Amendments**").[1] The Amendments will concern (I) arbitrability of certain types of corporate disputes, including those arising out of shareholders' agreement (the "**SHA**"), (II) the arbitrability of disputes arising out of the state procurement contracts, and (III) the set-up of Russia's system of permanent arbitration institutions (the "**PAIs**") and related issues of *ad hoc* proceedings.

The Amendments are a response to issues that arose in the practical application of the Arbitration Law in the last three years and a welcome step towards liberalizing certain requirements of the Arbitration Law and making arbitration in Russia more appealing to the market participants. However, certain questions on the application of the Arbitration Law (as described below) still remain unresolved.

If you have any questions concerning this memorandum, please reach out to your regular firm contact or the following author

MOSCOW

Marina Akchurina
+7 495 660 8582
makchurina@cgsh.com

Paveletskaya Square 2/3
Moscow 115054
T: +7 495 660 85 00

[1] 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**").

I. ARBITRABILITY OF CORPORATE DISPUTES

1. The Amendments simplify the requirements for arbitrability of corporate disputes relating to the SHAs and derivative actions (as defined below)[2]

Before the Amendments take effect, for a corporate dispute arising out of:

— SHAs regarding corporate management and governance; and

— disputes involving claims of the company's shareholders' for invalidation of the company's transactions, and application of the consequences of their invalidity (the "derivative actions")

to be arbitrable the following four conditions shall be met:

1) the arbitration shall be administered by a PAI;

2) the arbitration shall be governed by the special rules adopted by the PAI for the arbitration of corporate disputes;

3) all of the shareholders of the company, the company itself, and any other party involved in the dispute shall be parties to an arbitration agreement;

4) the Russian Federation shall be the seat of arbitration.

Condition 3) was of a particular concern in the SHA context because the latter is often entered into only by some of the company's shareholders and does not include the company itself. As a result under previous regime if a company had five shareholders and the SHA was entered into by four of them, the remaining shareholder and the corporation itself had to sign the related arbitration agreement (often as a side letter) notwithstanding the fact that they were not parties to the SHA. The requirement for all shareholders and the company itself to sign the arbitration agreement was also inconsistent with contemporaneous Russian court practice which did not consider the company to be a party to the SHA under Russian law.

The Amendments fix this issue. Under the new rules, it is sufficient for the parties to the SHA to sign the arbitration agreement; signatures of the shareholders that are not parties to the SHA and the corporation itself are no longer required. Similarly, derivative actions challenging the company's transaction are arbitrable provided that the arbitration agreement was entered into between the parties of the underlying transaction.[3]

In addition, the Amendments allow the PAIs to administer disputes arising out of the SHAs and associated corporate management matters without adopting the special rules governing arbitration of corporate disputes (condition 2)). Under conservative interpretation of the Amendments, condition 2) remains mandatory for derivative actions.

The Amendments, however, do not contemplate any changes to Art. 225.1 of the Arbitrazh Procedure Code which continue to require that conditions 2) and 3) are met for the disputes arising out of the SHA and derivative actions thereby creating a collision. Under the general rules of interpretation (*Lex posterior derogat prior*) the Amendments shall override the relevant provisions of the Arbitrazh Procedure Code concerning the same matters. However, the practical application of the Amendments by Russian courts in light of the collision with the Arbitrazh Procedure Code remains somewhat unpredictable.

The Amendments do not contain an express provision allowing its retroactive application to SHAs and corporate transactions entered into before 29 March 2019. Therefore, its application to SHAs

[2] *Ibid.*, Art. 7(7.1) (as amended by Art. 1(3) of the Amending Law).

[3] We note that pursuant to provisions of Art. 65.3(4) and 174 of the Civil Code of the Russian Federation, a corporation's transaction can be challenged by its director. It is unclear whether a director's claim would be subject to the existing arbitration agreement in respect of the challenged transaction. While referring the director's claim to arbitration would convey more accurately the intended meaning of the Amendments, the literal wording of the provisions may be interpreted to the contrary (*i.e.*, the director's claim shall be heard by a state court).

and other corporate transactions entered before 29 March 2019 remains unclear. Since the Amendments improve the position of the market participants, it may be argued that they shall apply retroactively.

2. Special PAI rules governing arbitration of corporate disputes are not necessary for arbitration of disputes arising out of the SPAs and activities of the share registrar[4]

The Amendments clarify that for corporate disputes involving (i) the ownership of shares (including disputes over SPAs), creating encumbrances over shares, and exercising rights attached to shares, and (ii) activities of share registrars, the PAI administering such disputes does not need to adopt special rules governing arbitration of corporate disputes. This provision is not a novelty but rather a confirmation of the common interpretation of the relevant provisions of the Arbitration Law that existed in the past.

II. ARBITRABILITY OF STATE PROCUREMENT DISPUTES

As discussed in our recent Review of arbitration-related cases, although with some exceptions, Russian courts have generally held that procurement for state controlled businesses under Federal Law No. 223-FZ may be subject to arbitration due to commercial nature of such activities. The Amendments build upon this approach and provide that disputes arising out of contracts entered into under or in connection with Federal Law No. 223-FZ may be referred to arbitration subject to certain conditions. Specifically, Article 45(10) of the Arbitration Law (as amended) provides that "[*i*]*f the seat of arbitration is in the Russian Federation*", then the procurement disputes "*can be heard only in arbitration administered by [a PAI]*".

Although the wording of Article 45(10) leaves some room for interpretation and may be read to mean that procurement disputes under or in connection with Federal Law No. 223-FZ may be seated outside Russia, the more conservative and likely interpretation of this provision (in light of the history of court cases that initially considered these disputes to be non-arbitrable) is that arbitration of such procurement disputes is only possible if: (a) such arbitration is seated in Russia, and (b) administered by a PAI.

III. PERMANENT ARBITRAL INSTITUTIONS

As a matter of brief background, the arbitration reform introduced the concept of a PAI, *i.e.*, a subdivision of a non-profit organization administering arbitration on a permanent basis. Foreign arbitration institution can obtain the status of a PAI.

To obtain the status of a PAI, the applicant must go through a complex bureaucratic process. Only PAIs are allowed to administer certain types of disputes in Russia and benefit from certain specific rights conferred thereto. To date, only four PAIs have been successfully established under the new regime. However, no foreign arbitration institution has received this status as of the date of this alert memorandum.

The Amendments provide for a more nuanced and somewhat more liberalized approach towards establishing a permanent arbitral institution in Russia.

1. The procedure for establishment (accreditation) of a PAI is now overseen directly by the Ministry of Justice rather than the Government of the Russian Federation[5]

The Amendments, however, do not change in principle the existing bureaucratic scheme under which the Council for the Advancement of Arbitration under the Ministry of Justice preliminary assesses the application for establishment of a PAI and then delivers its findings to the decision-making body (from now on, the Ministry of Justice), which subsequently grants or refuses the authorization to function as a PAI.

[4] *Arbitration Law*, Art. 45(7.1) (as amended by Art. 1(5)(б) of the Amending Law).

[5] *Ibid.*, Art. 44(1) (as amended by Art. 1(4)(a) of the Amending Law).

2. The application for granting the status of a PAI should be supported by documents exhaustively listed in the Arbitration Law[6]

Previously, the applicants had to comply with the fragmented requirements prescribed by the Ministry of Justice regulations; in reality, they were often confronted with vast administrative discretion. The Amendments provide for a more streamlined and transparent approach in respect of the list of the required supporting documentation. However, the Amendments still do not fully specify the requirements as to the contents of the supporting documents – *e.g.*, it remains unclear what items need to be submitted to demonstrate the arbitrators' "relevant experience".[7]

3. A restrictive approach is taken in respect of *ad hoc* tribunals, activities of which effectively fall under the PAI regime[8]

At the risk of unenforceability of the arbitral award, the Amendments impose a rigid constraint on entities and individuals involved in administering *ad hoc* arbitration proceedings that meet the implied criterion of regularity (*i.e.*, *de facto* constitute institutional arbitration). Such entities and individuals are also banned from advertising their services. The Amendments are in response to instances where the previously-established arbitral institutions actively continued to render *ad hoc* decisions after 1 November 2017 thus circumventing the PAI regime.

4. Foreign arbitral institutions do not need to establish a branch or representative office in Russia in order to apply for accreditation as a PAI (<u>unless</u> such institution intends to administer domestic disputes)[9]

Previously, the Ministry of Justice's publicly stated position was that a foreign arbitral institution seeking accreditation as a PAI in Russia would be required to establish a local branch (*обособленное подразделение*) in Russia. The Amendments, however, impose such a requirement only on arbitral institutions planning to administer domestic disputes. It remains to be seen how this rule will play out in practice given that major foreign arbitral institutions (ICC, LCIA, SCC etc.) do not distinguish between arbitration of domestic and cross-border disputes in their rules.

Additionally, the Ministry of Justice is expected to develop and publish criteria for establishing a "widely recognized reputation" of a foreign arbitral institution as mentioned in Art. 44(12) of the Arbitration Law, which is a step intended to ensure predictability in evaluating the foreign arbitration institution's application.

…

CLEARY GOTTLIEB

[6] *Ibid.*, Art. 44(6.1), 44(6.2), 44(6.3) (as amended by Art. 1(4)(ж) of the Amending Law).

[7] *See ibid.*, Art. 44(6.1)(10).

[8] *Ibid.*, Art. 44(20) (as amended by Art. 1(4)(л) of the Amending Law).

[9] *Ibid.*, Art. 44(12) (as amended by Art. 1(4)(и) of the Amending Law).