

INSIDE ARBITRATION: RUSSIAN COURTS TO HAVE EXCLUSIVE JURISDICTION OVER SANCTIONED PERSONS AND DISPUTES ARISING OUT OF SANCTIONS AGAINST RUSSIA: OVERVIEW OF THE NEW LAW AND PRACTICAL IMPLICATIONS

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Legal Briefings

On 8 June 2020, the Russian President signed a new federal law (No.171-FZ)¹ amending the Russian Arbitrazh (Commercial) Procedure Code (the “**Law**”), which will significantly change the dispute resolution landscape involving Russian individuals and entities subject to international sanctions. The Law came into force on 19 June 2020 and represents a significant development: it establishes exclusive jurisdiction of the Russian state arbitrazh (commercial) courts (the “**Russian Courts**”) with respect to disputes involving sanctioned Russian individuals and entities, as well as foreign entities controlled by them (together, the “**Sanctioned Persons**”), and disputes arising out of sanctions against Russia. According to the Law, such disputes may, in certain circumstances, be forcibly heard by the Russian Courts, even if the relevant contract or international treaty provides otherwise.

WHEN WILL THE RUSSIAN COURTS HAVE EXCLUSIVE JURISDICTION OVER SANCTIONED PERSONS?

In accordance with the Law, a Sanctioned Person can disregard the dispute resolution provisions in the contract and elect to refer the dispute to the Russian Courts, even if the contractual parties have agreed to the jurisdiction of a foreign court or an arbitral tribunal seated outside of Russia. This can be done where such provisions cannot be enforced because the imposition of sanctions has created obstacles to the Sanctioned Person's access to justice.

Some of the obstacles to justice arising out of sanctions against Russia with respect to Sanctioned Persons which are “SDNs” or “designated persons” under US and EU law respectively, may include, in particular, certain payment processing restrictions that are imposed on banks in relation to arbitration fees or state duties payable by them (and they may need to apply for a special exemption to make such payments). Sanctioned Persons may also experience difficulties in relation to appointing arbitrators or experts. In contrast, Sanctioned Persons falling under sectoral sanctions do not face such difficulties; however, in theory, they might also be able to refer their disputes to the Russian Courts because the Law does not require Sanctioned Persons to prove the connection between the dispute in question and the applicable sanctions.

In practice, Sanctioned Persons will assess the effect of the sanctions on their contracts, and, if there are grounds to believe that the applicable dispute resolution provisions cannot be enforced due to those sanctions, they will be entitled to refer their disputes for adjudication by the local Russian Courts. However, such referral will only be possible if there are no parallel foreign court or arbitration proceedings between the same parties in relation to a similar dispute.

A broad interpretation of the Law could also lead to the possibility of Sanctioned Persons disregarding dispute resolution provisions in a contract or an international treaty irrespective of their unenforceability, provided that parallel foreign court or arbitration proceedings between the same parties in relation to a similar dispute have not already been initiated. However, it remains to be seen how the Russian Courts will interpret the Law.

WHAT A SANCTIONED PERSON WILL BE ABLE TO DO IF THE FOREIGN COURT OR ARBITRATION PROCEEDINGS ARE PENDING OR IMMINENT?

If there are pending foreign court or arbitration proceedings in place or such proceedings are imminent, and either the Sanctioned Person believes that the applicable dispute resolution provisions agreed by the parties cannot be enforced due to the sanctions or no dispute resolution clause was agreed by the contractual parties, the Sanctioned Person is entitled to apply to the Russian Courts for an anti-suit injunction preventing the commencement or continuation of such proceedings. The onus will be on the Sanctioned Person to demonstrate that the foreign proceedings are either pending or imminent.

The Sanctioned Person may apply for an order requiring an opposing party who fails to comply with the anti-suit injunction to pay monetary compensation to the Sanctioned Person of up to the amount claimed in the foreign court or arbitration proceedings, plus legal and court fees. There is also a high risk that a decision or award rendered by a foreign court or an arbitral tribunal as a result of such parallel proceedings will not be enforceable in Russia.

In any event, it remains to be seen whether anti-suit injunctions imposed by the Russian Courts will be enforced by foreign courts or arbitration institutions seated outside of Russia. For instance, the Russian Courts refuse to enforce anti-suit injunctions against the commencement and continuation of proceedings in the Russian Courts which have been issued by foreign courts². Nevertheless, the opposing parties will bear the negative consequences of failing to comply with the anti-suit injunctions imposed by the Russian Courts in the territory of the Russian Federation.

HOW WILL THE RUSSIAN COURTS DETERMINE THAT THE DISPUTE RESOLUTION CLAUSE IS UNENFORCEABLE?

It remains to be seen on what bases the Russian Courts will determine that a dispute resolution clause involving a Sanctioned Person may be rendered unenforceable due to sanctions creating obstacles to the Sanctioned Person's access to justice. Equally, at present it is unclear what factors will influence the Russian Courts' views when making a determination as to enforceability. This issue has already been discussed by the Russian Courts in at least one case prior to the adoption of the Law. In *Instar Logistics LLC v Nabors Drilling International Ltd* (Case number [A40-149566/2019](#)) ("*Instar Logistics*"), the Arbitrazh (Commercial) Court of Appeal held that an ICC arbitration clause was unenforceable due to the imposition of US sanctions, concluding that the Russian Courts should have jurisdiction instead. According to the Court, the claimant, a Russian company subject to US sanctions, could not recover a debt from the defendant, a Russian branch of a US company, in reliance on the arbitration clause in the contract. The Court decided that the clause placed the defendant in a more favourable position, given that an arbitral award in favour of the claimant would not be enforceable due to bank transfer restrictions as a result of the sanctions. Therefore, it seems that the Court of Appeal effectively equated the "enforceability of a dispute resolution provision" with the "enforceability of a foreign court decision or an arbitral award".

The Arbitrazh (Commercial) Court of the Moscow District has recently upheld the decision of the Court of Appeal in Instar Logistics. The Moscow District Court dismissed the defendant's appeal on formal grounds without making any substantive comments in relation to the provisions of the Law, or the manner in which the phrases “enforceability of a dispute resolution clause” and “obstacles to access to justice” should be interpreted (even though the claimant made a reference to the Law in its submissions). Although the decision of the Moscow District Court does not set a binding precedent under Russian law, its silent agreement with the Court of Appeal may well have a persuasive effect in the future, such that the lower courts will follow suit.

WHAT HAS BEEN THE RESPONSE OF FOREIGN ARBITRAL INSTITUTIONS TO SANCTIONS?

In August 2015, the London Court of International Arbitration (the “**LCIA**”), together with the Stockholm Chamber of Commerce (the “**SCC**”) and the International Chamber of Commerce (the “**ICC**”), published a joint note confirming that sanctions do not impose a general prohibition on parties seeking arbitration administered by these arbitral institutions, and Sanctioned Persons are not treated differently from other parties (subject to compliance measures that arbitral institutions are required to implement).³

The LCIA has also confirmed that it has not experienced a significant impact on its ability to administer arbitrations involving Sanctioned Persons, although a limited number of administrative steps have been added to the case management process, so as to ensure that any necessary exemption application can be made to the relevant authorities.⁴

Further, on 17 June 2020, the Hong Kong International Arbitration Centre (the “**HKIAC**”) held a webinar which addressed, in particular, the consequences of the Law.⁵ It was stressed that since (1) Hong Kong has not adopted sanctions against Russia, and (2) on 25 April 2019 the HKIAC was granted permanent arbitration institution, there is a compelling argument that choosing the HKIAC as the arbitral forum in the relevant contract should not create an obstacle to access to justice with respect to a Sanctioned Person.

It remains to be seen whether the Russian Courts will take into account the statements and practices of foreign arbitral institutions, such as the LCIA, the SCC, the ICC and the HKIAC, when applying the Law.

The new Law should not affect the arbitration clauses providing for the competence of arbitral institutions with a seat in Russia.

WILL AN ARBITRAL AWARD OR A FOREIGN COURT DECISION AFFECTING A SANCTIONED PERSON BE ENFORCEABLE IN RUSSIA?

The Law clarifies that, despite the Russian Courts having exclusive jurisdiction over disputes involving Sanctioned Parties, a foreign court decision or an award of an arbitral tribunal seated outside of Russia that affects a Sanctioned Person can nevertheless be recognised and enforced in Russia (albeit in limited circumstances) in accordance with the general recognition and enforcement rules.

Russia has been a party to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards since 1960 (the “**New York Convention**”) (replacing the former Soviet Union as a member state in 1991), and is a party to a number of international treaties which provide for enforcement of foreign court judgments and arbitral awards.⁶ Therefore, the foreign party could rely on the relevant international instrument to ensure recognition and enforcement of the relevant court decision or award against the Sanctioned Person in Russia.

This will be possible where the Sanctioned Person did not object to the jurisdiction of the foreign court or the arbitral tribunal during the court or arbitration proceedings and did not apply for an anti-suit injunction in the Russian Courts.

In addition, recognition and enforcement of a foreign court decision or an award of an arbitral tribunal seated outside of Russia that affects a Sanctioned Person will be possible where it was the Sanctioned Person that filed the claim which resulted in the arbitral award or court decision in question.

WHAT ARE THE PRACTICAL IMPLICATIONS OF THE LAW FOR BUSINESSES DEALING WITH RUSSIAN COUNTERPARTIES?

Businesses dealing with Russian counterparties will need to do their due diligence and carefully monitor whether the counterparty is, or has become, a Sanctioned Person and whether sanctions could affect the enforceability of the dispute resolution clauses in their contracts. If this is the case, they need to be aware that their disputes may be considered by the Russian Courts, even though the parties have agreed to, or an international treaty provides for, an arbitration with a non-Russian seat or the jurisdiction of a foreign court.

As Russian law does not have extraterritorial effect, the foreign counterparty could nevertheless succeed in obtaining and enforcing abroad a foreign court decision or a foreign arbitral award in spite of the anti-suit injunction granted by the Russian Courts. However, the foreign counterparty will also need to assess whether the relevant Sanctioned Person has any readily available assets outside of Russia that could be subject to foreign enforcement proceedings.

In addition, the foreign counterparty will have to deal with and bear the consequences of any parallel proceedings in the Russian Courts which are initiated in accordance with the Law. The foreign counterparty will need to assess whether the Russian Court judgment issued as a result of such proceedings (including, if applicable, the anti-suit injunction order) can be enforced against any assets in Russia. Likewise, it should consider whether the Russian judgment could be recognised and enforced against its assets abroad.

The Law has no provisions on application in time, meaning it may have consequences not only for future, but also for existing disputes.

ARE THERE ANY ISSUES TO CONSIDER AT THE TIME OF CONTRACTING?

At the time of contracting the foreign counterparty will need to consider whether any substantive contractual mechanisms are available to protect its interests in circumstances where the Sanctioned Person decides to rely on the new Law in the future. The availability and extent of such mechanisms will, in particular, depend on the governing law of the contract and the parties' respective bargaining powers.

The parties may also consider selecting dispute resolution mechanisms that are less likely to be affected by sanctions (and, consequently, by the Law) so as to mitigate against the possible impact on any proceedings. For example, one method might be to select a seat of arbitration or an arbitral institution that is unlikely to be affected by the EU or the US sanctions or an arbitral institution with a seat in Russia. Alternatively, the parties may consider including a so-called "cascade" arbitration agreement that would allow the parties to refer their dispute to arbitration proceedings which will be administered by an alternative arbitration institution if, due to sanctions, the dispute cannot be administered by a first choice arbitration institution.

COMMENT

The Law generally conforms with the trend determined by the amendments to the Russian Constitution, which effectively establish the primacy of Russian law and the Russian Constitution over international law⁷, which were adopted following the referendum on 1 July 2020.

The Law may further complicate the already complex arbitration regime established as a result of the Russian arbitration reforms in 2016 and 2019, which aimed to eliminate the widespread practice of companies setting up their own "pocket" arbitration institutions to administer disputes.

Although international sanctions only apply to certain Russian companies and nationals, and do not impact or restrict dealings with Russian companies in general, the new Law could impact the investment climate in Russia due to the additional level of complexity and uncertainty it introduces.

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1. The text of the Law is available at <http://publication.pravo.gov.ru/File/GetFile/0001202006080017?type=pdf>
 2. See para 32 of Informational letter of the Supreme Arbitrazh Court Presidium No. 158 dated 09 June 2013.
 3. <https://www.lcia.org/News/the-potential-impact-of-the-eu-sanctions-against-russia-on-inter.aspx>
 4. <https://www.lcia.org/adr-services/lcia-notes-for-parties.aspx#20.%20SANCTIONS,%20RESTRICTIVE%20MEASURES%20AND%20ABILITY%20TO%20PARTICIPATE>
 5. <https://hkiac.eventbank.com/resources/protected/organization/917/event/21180/1e6323b8-d786-4138-8734-06deac824381.pdf> and https://zoom.us/rec/share/x9MoNLStqTpOE4n1yE_5UflwFKa5aaa8gCQW_fRcxEqGxMTydZYF7rgcg1_GUOSH?startTime=1592378735000
 6. Such treaties are currently in force with several countries that are members of the Commonwealth of Independent States and some former socialist states in Eastern Europe, but only a few Western jurisdictions. Russia is not a party to the 1968 Brussels Convention on jurisdiction and the enforcement of judgments in civil and commercial matters, the 2007 Lugano Convention on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, or the 2005 Hague Convention on Choice of Court Agreements.
 7. The text of the amendments to the Russian Constitution is available at <http://duma.gov.ru/news/48045/>

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KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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