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Arbitration Hurdles Facing Foreign Investors in Russia: Analysis of Present Issues and Implications

Elliot Glusker*

I. INTRODUCTION

Russia has come a long way since the collapse of the Soviet Union in 1991, but there are still some structural reforms that need to take place in order to increase investor confidence. In 2007, one hundred billion dollars was invested in Russia from overseas, which represents a record for a developing market economy.¹ However, direct foreign investment in Russia is still low compared to other European nations.² Foreign investment is one of Russia's main strategies for improving the long-term health of the economy. There is a lot of promise for future economic growth, but some recent actions by the Russian state and the legacy of the Soviet system continue to hamper the development of a truly healthy business climate.

One of the biggest issues that foreign investors face in Russia is enforcement of contracts when deals fall apart or one side breaches the contract.³ Contract enforcement is a huge concern in the former Soviet region due to the fact that commercial courts, arbitration services, and bailiffs are not as effective, experienced, and autonomous as they are in the

* Elliot Glusker graduated with a JD/MBA from Pepperdine University School of Law and Graduate School of Business and Management. He grew up and lived in Russia until 1996.

1. Vladimir Kvint, *Russia's Surging Economy*, Jan. 8, 2008, FORBES, available at http://www.forbes.com/opinions/2008/01/08/russia-economy-projections-oped-cx_vkv_0108russia.html.

2. U.S. Department of State, *2006 Investment Climate Statement - Russia*, <http://www.state.gov/e/eeb/ifd/2006/62376.htm> (on file with author).

3. *What Can Be Done When Deals Go Bad?*, EBRD, Jan. 6, 2004, <http://www.ebrd.com/new/stories/2004/040106.htm>. The legal framework has been improving but greater reliability is needed. *Id.* "[M]any foreign investors shy away from the region because they 'remain to be convinced that their contractual arrangements will be upheld if they need to seek legal remedies to enforce their rights or recover their claim.'" *Id.*

Western regions.⁴ In addition, the legacy of corruption that carried over from the Soviet era exacerbates the problem even further.⁵ Many foreign investors feel that Russia offers plenty of investment opportunities, but they quickly encounter that conducting business in Russia can be rather difficult. This article will look at the legal and regulatory environment, specifically focusing on arbitration in order to ascertain if arbitration is an effective and reliable dispute resolution method for foreign investors doing business in Russia. The article will examine various arbitration hurdles that foreign businesses and investors in Russia are likely to encounter and will offer advice on how to avoid or overcome these obstacles.

The first section of this article describes the effectiveness of arbitration in international commercial disputes conducted in Russian arbitration tribunals. The second section analyzes the enforcement of foreign arbitration awards by Russian courts, closely examining some of the reasons employed by Russian courts in refusing to enforce foreign arbitration awards. Lastly, the third section of this article looks at the international arbitration claims filed against the Russian state and examines the issues that foreign investors are likely to face while arbitrating those claims.

II. EFFECTIVENESS OF INTERNATIONAL ARBITRATION CONDUCTED IN RUSSIAN ARBITRATION TRIBUNALS

Overall, Russia has several well-respected arbitration institutions that are capable of handling commercial disputes involving foreign parties. However, many investors still choose to conduct arbitration proceedings abroad despite the fact that foreign arbitration awards can be hard to enforce.⁶ Private commercial arbitration institutions in Russia have several weaknesses such as general unfavorability for Russian commercial law, potential jurisdictional issues, enforcement of arbitral awards, and lack of trust in Russian courts.

4. *Id.*

5. *Id.*

6. *See infra* notes 72-97 and accompanying text (discussing some of the problematic reasons employed by Russian courts in refusing to enforce foreign arbitration awards).

[Vol. 10: 3, 2010]

PEPPERDINE DISPUTE RESOLUTION LAW JOURNAL

A. Overview of Bodies Involved in Dispute Resolution

There is often confusion among those who are unfamiliar with the legal system in Russia about the function of arbitrazh courts.⁷ The arbitrazh courts are a system of courts that hear commercial disputes; however, they are not arbitration tribunals and operate as regular courts staffed by full-time judges that are paid by the state.⁸ Classical arbitration in Russian is referred to by the term “treteiskii sud” or “third-party court.”⁹ The two oldest traditional arbitration institutions in Russia are the Maritime Arbitration Commission (MAC) and the International Commercial Arbitration Court (ICAC).¹⁰ Some of the newer institutions include the Arbitration Court at St. Petersburg Chamber of Commerce and Industry (Arbitration Court at St. Petersburg) and the newly developing alternate dispute resolution (ADR) system of the Russian Union of Industrialists and Entrepreneurs.¹¹

B. Unfavorability of Russian Commercial Law and Jurisdictional Issues

ICAC is considered to be one of the best and most popular forms of private dispute resolution in Russia today¹² but it is questionable whether it is the best choice for foreign investors. Russian parties are increasingly choosing to litigate major cases in foreign arbitration venues such as

7. SARAH REYNOLDS, HANDBOOK ON COMMERCIAL DISPUTE RESOLUTION IN THE RUSSIAN FEDERATION: A GUIDE FOR BUSINESSES ON NAVIGATING THE RUSSIAN LEGAL SYSTEM FOR RESOLUTION OF BUSINESS DISPUTES 9 (U.S. Dept. of Commerce July 2000). “This confusion is quite understandable, since the adjective ‘arbitrazh’ and the term ‘arbitrazh court’ are used in Russian to refer to two different kinds of bodies . . .” *Id.* Sometimes, the word ‘arbitrazh’ is used to refer to traditional forms of arbitration. *Id.*

8. *Id.*

9. *Id.* This article will minimize any potential confusion by referring to the state court system as “arbitrazh courts” and the traditional form of arbitration as “arbitration” instead of other commonly used terms such as “arbitrazh” or “arbitrazhnyi.”

10. *Id.* ICAC is one of the most organized and respected Russian arbitration tribunals. Mikhail A. Rozenberg, *Commercial Dispute Resolution in Russia*, RUSSIAN INVESTMENT REV., Oct. 2006, at 44, available at <http://www.chadbourne.com/publications/> (search “dispute resolution in Russia”). ICAC can hear disputes in Russian or English; additionally, it hears cases when parties agree to arbitrate in ICAC in their arbitration clause. *Id.* ICAC awards are generally considered final and can only be reversed under limited circumstances. *Id.* at 45. See also *infra* notes 29-31 and accompanying text.

11. U.S. Department of State, *supra* note 2.

12. See Rozenberg, *supra* note 10, at 44.

London, Stockholm, Paris, and New York.¹³ Most litigants prefer foreign law because there are more settled legal principles that benefit all parties.¹⁴ Russian commercial law is difficult to predict since there is no reliable consistent precedent.¹⁵ Also, Russian commercial law does not “[r]ecognise a number of western legal concepts, such as representations and warranties and indemnities.”¹⁶ “The legal system in Russia is still in a state of flux, with various parts of government struggling to create new laws on a [range] . . . of topics.”¹⁷ Various jurisdictions and branches apply legal principles differently, so it is crucial for those investors contracting to arbitrate inside of Russia to choose foreign law as the governing law.¹⁸ However, Russian law must govern tax disputes with the Russian tax authorities and bankruptcy proceedings involving Russian entities, and dispute resolution must be held in Russia.¹⁹ Foreign investors should review each contract they enter into to make sure that they are in compliance with all commercial codes and regulations. An investor has to be aware of constant changes made by government resolutions and contract to arbitrate under foreign law whenever possible.

Jurisdictional issues can also arise in international commercial arbitration taking place inside of Russia. There is a lack of legislative clarity concerning arbitral awards issued inside of Russia in which one of the parties is foreign.²⁰ The 1993 Law of the Russian Federation on International Commercial Arbitration (1993 Law) applies to international commercial disputes arbitrated in Russia.²¹ Domestic disputes resolved through arbitration are governed by a different set of rules under the Temporary Statute on Arbitration Tribunals for the Resolution of Economic Disputes (Temporary Statute).²² The Temporary Statute essentially governs arbitration disputes that would otherwise be subject to the jurisdiction of

13. *Id.* at 45.

14. *Id.*

15. *Id.*

16. *Id.* Parties to commercial contracts in Russia often select English law to settle potential disputes and choose the London Court of International Arbitration (LCIA) as their forum. *Id.*

17. U.S. Department of State, *supra* note 2.

18. *Id.*

19. Rozenberg, *supra* note 10, at 45.

20. REYNOLDS, *supra* note 7, at 132.

21. *Id.* at 136. International commercial disputes are those disputes that involve at least one foreign party, so all commercial disputes where one of the parties is a foreign investor would be considered international. *See id.* at 132.

22. *Id.* at 136. The Temporary Statute has different procedural grounds for execution and enforcement but most importantly the “Temporary Statute allows the arbitrazh court to review the decision of the arbitration tribunal in its substance.” *Id.* at 134.

[Vol. 10: 3, 2010]

PEPPERDINE DISPUTE RESOLUTION LAW JOURNAL

arbitrazh courts.²³ Under the Temporary Statute, the arbitrazh court can consider if the decision of the arbitration tribunal is in accord with the substantive law.²⁴ The confusion in deciding which law applies stems from the fact that the arbitrazh courts would decide most international commercial disputes that are not arbitrated and, therefore, the Temporary Statute would seem to govern.²⁵

The state arbitrazh court also has the right to hear international commercial disputes if one of the parties does not object or move to enforce the arbitration clause.²⁶ Furthermore, an arbitrazh court can assert jurisdiction under certain circumstances if it determines that the arbitration clause is invalid or cannot be enforced.²⁷ Also, there may be disagreements between courts regarding jurisdiction over the enforcement of arbitral awards in international commercial arbitration taking place inside of Russia.²⁸ Foreign investors should only participate in older and established arbitration tribunals such as ICAC and MAC in order to minimize any potential jurisdiction issues and conflicts. Another important takeaway is to carefully draft arbitration clauses, preferably using proven or proposed model arbitration clauses offered by such institutions as ICAC. This would most likely eliminate any interference by arbitrazh courts on the basis that

23. *Id.* at 133.

24. REYNOLDS, *supra* note 7, at 134.

25. *Id.* at 135. The Temporary Statute governs arbitration disputes which would otherwise fall under the jurisdiction of arbitrazh courts. *Id.* Thus, it would seem that international commercial disputes should fall under the Temporary Statute. This would make arbitration extremely unattractive since it would allow arbitrazh courts to substantively review arbitration awards. *See id.* at 134. The only clear exceptions to this are the ICAC and the MAC, which are exempted from the rules of the Temporary Statute. *Id.* at 135. It is not exactly clear what laws would apply to a relatively new arbitration institution such as the Arbitration Court at St. Petersburg. The newer Russian arbitration institutions are also a riskier choice due to the fact that they have less experience in arbitrating international disputes. The confusion as to which law would apply arises because of the changes that occurred over the years. *Id.* at 136. “[W]hen [1993 Law and Temporary Statute]... were adopted, the arbitrazh courts had no jurisdiction over cases concerning international commercial matters, and the only arbitration tribunals hearing such matters were those specifically excluded from the scope of application of the Temporary Statute.” *Id.* Subsequently, arbitrazh courts have been given jurisdiction over international commercial matters and many new arbitration tribunals have been formed. *Id.*

26. Rozenberg, *supra* note 10, at 44-45.

27. *Id.* at 45.

28. REYNOLDS, *supra* note 7, at 136. Art. 1 of the Temporary Statute provides that the Temporary Statute will not apply to foreign parties but this strict interpretation is not always followed by state courts. *Id.* The determination of jurisdiction is important because it prescribes what rules and procedures for enforcement and review will be used. *See id.* at 135-36.

the arbitration clause is invalid. However, despite these precautions, investors could run into the problem of enforcing and executing decisions issued by domestic arbitration tribunals.

C. *Enforcement of Arbitration Awards Issued in Russia*

The 1993 Law which lists the standards for enforcement, was partly designed to implement the New York Convention, with Articles 35 and 36 outlining the grounds for refusal of recognition or enforcement of a foreign arbitration award.²⁹ Article 34 of the 1993 Law lists the grounds under which courts can reverse an arbitral award issued in Russia concerning international disputes.³⁰ The primary difference is that international arbitration awards issued inside of Russia might be reversed by a Russian court, while those same circumstances would only lead to the refusal to recognize and enforce a foreign arbitral award.³¹

One of the weaknesses of the Russian arbitration system stems from the fact that arbitration awards must be enforced by an arbitrazh court.³² Some in Russia prefer litigation over arbitration due to the fact that compulsory enforcement of an arbitral award requires a court order.³³ One potential advantage of arbitrazh courts is that they have the power to freeze bank accounts because in many cases defendants transfer assets before an arbitral

29. REYNOLDS, *supra* note 7, at 136.

30. *Id.* Reynolds lists the following specific grounds:

1. One of the parties to the arbitration agreement did not have legal capacity or the agreement itself was void by the applicable law, or if the applicable law is not stated by the law of the Russian Federation;
2. The party challenging the award was not properly notified of the appointment of an arbiter or of the consideration by the tribunal or for another reason was not able to present its explanation;
3. The award was issued concerning a dispute not subject to arbitration agreement; or
4. The composition of the arbitration tribunal or the arbitration procedure was not in accord with the agreement of the parties, if they could have legally agreed on those issues under the 1993 Law, or was not in accordance with the law.
5. In addition, the award may be reversed by a court on the grounds that the . . . dispute may not be the subject of arbitration according to the law of the Russian Federation or that award violates the public policy of the Russian Federation.

1993 Law of the Russian Federation on International Commercial Arbitration, art. 34.

31. REYNOLDS, *supra* note 7, at 137.

32. Rozenberg, *supra* note 10, at 45. "As with international arbitral procedures, the weakness in the system is in Russian enforcement of decisions." U.S. Department of State, *supra* note 2. The execution order can only be issued by a Russian court or arbitrazh court. REYNOLDS, *supra* note 7, at 107.

33. Karen Halverson, *Resolving Economic Disputes in Russia's Market Economy*, 18 MICH. J. INT'L L. 59, 90-91 (1996).

[Vol. 10: 3, 2010]

PEPPERDINE DISPUTE RESOLUTION LAW JOURNAL

award can be enforced.³⁴ In addition, Russian jurists often criticize interference of economic courts in the arbitration process.³⁵ There should be legislative reform that enhances the independence of domestic Russian arbitration and does not make it so dependent on enforcement by arbitrazh courts and execution by bailiffs.³⁶ As it presently stands, foreign investors could obtain a favorable arbitral award, but it might be reversed or not enforced by an arbitrazh court.

Nevertheless, even if a foreign investor has been able to obtain a favorable decision from the arbitrazh court, they must take additional action to make sure that the decision is executed.³⁷ The Law of the Russian Federation "On Court Bailiffs" created a Court Bailiffs Service (sometimes referred to as "court enforcers") responsible for carrying out the execution of judgments.³⁸ The problem is that bailiffs report to the Ministry of Justice and not the court, so the "courts can do little to ensure that decisions, once passed down, are executed."³⁹ There are several cases where, despite repeated favorable court decisions, foreign investors have not been successful in enforcing a judgment against a local party or the local government.⁴⁰ "[C]ourt decisions have not been executed because of undue influence on enforcement officers or the absence of effective enforcement mechanisms."⁴¹ Investors are often deterred because of the difficulty of being able to obtain enforcement and execution of a judgment.⁴² There is a general level of distrust for the court system in Russia due to the prevalence of corruption within the courts.⁴³

34. *Id.* at 90. However, in practice this advantage is not as important due to the corrupt nature of the economic courts and the fact that they do not often use this power. *Id.* at 91.

35. *Id.* at 92. *See supra* notes 20-25 and accompanying text.

36. *See generally id.* at 92.

37. REYNOLDS, *supra* note 7, at 108.

38. *Id.* at 112. The court bailiffs service is an executive body that reports to the Ministry of Justice financed through the federal budget. *Id.* In Russia "court enforcers" have the right to use physical force and weapons if other means are not effective. *Id.*

39. U.S. Department of State, *supra* note 2.

40. *Id.*

41. ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT [OECD], THE INVESTMENT ENVIRONMENT IN THE RUSSIAN FEDERATION: LAWS, POLICIES, AND INSTITUTIONS 17 (2001), <http://www.oecd.org/dataoecd/49/56/1911879.pdf>.

42. *Id.* at 16. The institutional barriers are a result of lack of independence of the judiciary. *Id.* at 17.

43. *See* Ethan S. Burger, *Corruption in the Russian Arbitrazh Courts: Will There Be Significant Progress in the Near Term?*, 38 INT'L LAW. 15, 16 (2004).

D. Corruption and Lack of Trust in Russian Courts

One of the characteristics of the Russian legal system is the pervasiveness of corruption.⁴⁴ There is no universally accepted definition of corruption. It is defined as using an office for personal gain, but the specific context of corruption can take a variety of forms, such as nepotism for example.⁴⁵ Another form of corruption involves the application of law for political or other reasons instead of the actual merits.⁴⁶ According to Transparency International's 2007 Corruption Perceptions Index, Russia was ranked 143 out of 180 countries.⁴⁷ Georgy A. Satarov, President of the INDEM Center for Applied Political Studies, estimated that court officials received annual bribes equivalent to at least \$274 million.⁴⁸ Judges are more likely to favor large local entrepreneurs over foreigners, since the large local enterprises provide employment and taxes to the local populations.⁴⁹ Jeffrey M. Hertzfeld, one of the leading Western attorneys in Russian law, was quoted as saying that "many foreign investors have found it difficult, if not impossible, to have their rights recognized, particularly when they find themselves in conflict with a politically powerful or well-connected Russian

44. John B. Attanasio, *Interconnection of Legal/Constitutional Reform and Economic Reform – Success?*, 34 INT'L LAW. 201, 202 (2000). The Soviet Union was a lawless state that reduced all law to power. *Id.* at 203. There was no rule of law and many believed that the "best capitalist is the best crook." *Id.* During the era of the Soviet Union, bribes and other forms of corruption were prevalent and the government interfered in legal cases. *Id.* at 204.

45. Burger, *supra* note 43, at 15 n.3. Corruption can also mean dealing with a matter for political or other reasons instead of the actual merits. *Id.* This form of corruption becomes extremely important when looking at seizures by the Russian state in the energy sector. *See id.*

46. *See infra* notes 111-112 and accompanying text. As discussed in Section IV of the article, this definition of corruption is crucial for analyzing the current issues facing foreign investors in international commercial arbitration against the Russian state.

47. Robert W. Orttung, *Nations in Transit 2008*, FREEDOM HOUSE 495, 513, http://www.freedomhouse.hu/images/fdh_galleries/NIT2008/NT-Russia-final1.pdf. Russia received a 2.3 score on a 0-10 scale, where ten is perceived to be the least corrupt. *Id.* at 513. Despite some attempts by former President Vladimir Putin and the current President Dmitry Medvedev to address corruption there is still no clear strategy for combating corruption. *See id.*

48. Burger, *supra* note 43, at 18. Judicial corruption is not only found in Russia, but "[w]hat makes Russia unique" is the fact that Russia has a vast wealth of natural resources and an educated population making it attractive to investors. *Id.* at 18-19. The result is that foreign courts and international arbitral tribunals will have to address the effects of this corruption more often. *Id.* at 19.

49. *Id.* at 22. Judges tend to dispose of troublesome cases through technicalities rather than resolving them on the merits. *Id.* Of course, this tends to effect arbitration cases because arbitrazh courts have to enforce the award and bailiffs have to execute it. As discussed earlier, arbitrazh courts could reverse a reward rendered by a domestic tribunal, or even review the award in substance if it was issued by a relatively new arbitration institution. *See supra* notes 20-25, 30-31 and accompanying text.

[Vol. 10: 3, 2010]

PEPPERDINE DISPUTE RESOLUTION LAW JOURNAL

party.”⁵⁰ The use of private arbitration in Russia does not circumvent these issues entirely because arbitral awards can still be challenged on a wide range of grounds.⁵¹

The reason why even many Russian companies prefer to file their suits abroad is a lack of trust in Russian courts.⁵² Bribe taking does exist, but pressure on judges can be exercised in other ways.⁵³ Often administrative pressure by the local Russian authorities can influence the judge’s decision.⁵⁴ Judges and court officials are financially dependent on local government in most of Russia’s regions,⁵⁵ which might make them biased when reviewing and enforcing arbitral awards. Foreign investors complain that it is difficult to win a case against the Moscow city government because the city government pays judges significant bonuses to supplement their low salaries.⁵⁶

Despite the increase in popularity of Russian arbitration institutions and formation of new domestic tribunals, most foreign investors still prefer to insert dispute resolution clauses in their clients’ commercial contracts that provide for international arbitration.⁵⁷ Nevertheless, favorable foreign awards are also often difficult to enforce and execute in Russia.⁵⁸ In certain circumstances, for example when the Russian party has no assets abroad, investors might choose to settle their dispute through ICAC. An institution such as ICAC can be an efficient way to resolve international commercial disputes, but investors still need to be wary of potential issues, especially when they are arbitrating against the Russian state or an influential local enterprise. In that case, an international arbitration tribunal might be a better suited strategy, and the investor could successfully attach Russian assets

50. Burger, *supra* note 43, at 26.

51. *Id.* See *supra* notes 30-35 and accompanying text. See also 1993 Law of the Russian Federation on International Commercial Arbitration, art. 34.

52. Sophie Lambroschini, *Russia: Judges, Plaintiffs, Defendants Face Arbitration Court Problems – Part 2*, RADIO FREE EUROPE/RADIO LIBERTY, Apr. 25, 2001, available at <http://www.cdi.org/russia/Johnson/5223.html##12> (quoting Oleg Fyodorov).

53. *Id.*

54. *Id.*

55. See *id.*

56. *Id.*

57. Burger, *supra* note 43, at 26.

58. *Id.* A victorious foreign investor may have to attach Russian assets in third countries in order to get paid. *Id.* at 27. International arbitration might not be the right strategy, though, for those investors whose Russian counterparts have no assets abroad. See *id.* at 26.

abroad if the foreign award is not properly enforced and executed by an arbitrazh court.⁵⁹

59. The process of asset seizures and forfeitures in the international arbitration context is rather complicated and varies depending on the specific sovereignty laws of the country where one is seizing assets. See International Seizure and Forfeitures, INTERNAL REVENUE SERVICE, http://www.irs.gov/irm/part9/irm_09-007-010.html (last visited Apr. 23, 2010). The first step in any seizure action is to identify the assets and plan the seizure process. *Id.* at 9.7.10.3.1. During the planning stage, the investor should consider the laws of the country where the seizure is taking place because “some governments have specific laws that state that it is illegal for any other sovereignty to own property in their country.” *Id.*

Since the NY Convention only deals with the *enforceability* of a foreign arbitral award, it does not provide for harmonized law in the subsequent *enforcement* proceedings. As a result, even among the 133 member states of the NY Convention, there are (at least) 133 different legal systems on how to execute an enforceable award against the debtor’s assets.

Peter Stankewitsch, *Enforcement of Arbitral Awards Against Russian Companies Outside Russia 5*, BAKER & MCKENZIE, <http://www.bakernet.com/NR/rdonlyres/EB217E40-5DDD-457B-B8AE-AD13156719E4/28743/Dr.pdf>. The next step is to apply to freeze or seize the assets in the country where the investor is seeking to initiate the attachment process. There are several issues that investors might encounter while seeking to attach Russian owned assets abroad. First, according to the rule of territoriality, it is against international law for a country to allow the attachment of assets beyond its territorial sovereignty. *Id.* at 7. It is easy to determine the location of tangible property like real estate but what about the location of stock certificates? See *id.* It is hard to determine the location of share certificates because there is no universally accepted answer, therefore “[t]he determination of the correct enforcement measures and the international reach of such measures - depends on the applicable local laws.” *Id.* For example, if

[T]he judgment creditor wants to enforce the arbitral award against certain Eurobonds held by a Russian debtor, the judgment creditor has to find out whether the local enforcement laws provide for different rules depending on the nature of the security and, in this case, what is the nature of the security pursuant to the chosen law. If, according to the chosen law, the Eurobonds can be traded by a simple transfer of the certificate, the creditor can, e.g., try to get hold of the Eurobonds while they are in Germany, because German law on enforcement allows a seizure of such securities by a simple attachment of the certificate by a bailiff.

Id. at 9. The determination of the location of accounts receivables also varies because some local enforcement laws consider the location to be at the creditor’s domicile, while others determine it at the debtor’s domicile or the country where payment is carried out. *Id.* at 9-10. Another important issue that investors will have to plan for is the fact that foreign assets can only be attached if they can be attributed to the judgment debtor’s property based on the applicable local property law. *Id.* at 8. Therefore, generally an investor would not be able to enforce an arbitral award against a subsidiary of the debtor because the subsidiary would be treated as a third party not part of the arbitration proceedings. *Id.* The law in regards to whether holding the parent company liable for its subsidiary’s debts or vice versa, a concept known as “piercing the corporate veil,” can apply to enforcement proceedings is unsettled. *Id.* at 11. There are many other issues, which investors might come across while seeking to successfully seize Russian assets abroad, so choosing excellent legal representation is vital. The steps outlined above are a rough summary and investors will have to follow the rules of the country that they are dealing with. It is important to remember that attaching assets abroad is a long process and one can only be successful if they are persistent, patient and determined.

III. ENFORCEMENT OF FOREIGN ARBITRAL AWARDS BY RUSSIAN COURTS

Recognition and enforcement of foreign arbitration awards in Russia are governed by the New York Convention of 1958 (NY Convention), to which Russia is a party.⁶⁰ Therefore, Russian courts should only refuse to enforce foreign awards under the terms of the NY Convention and should not make their judgments based on the content or outcome of the foreign award.⁶¹ “However, the fact remains that there are numerous cases of local courts failing to execute international arbitration awards on spurious or trumped-up grounds.”⁶² In order to make international commercial arbitration a reliable

60. REYNOLDS, *supra* note 7, at 134. Russia implemented the NY Convention under art. 35 and 36 of the 1993 Law “On International Commercial Arbitration.” *Id.* at 135. The articles define the conditions for enforcement of foreign awards, repeating the provisions of the NY Convention. *Id.* According to Art. V of the NY Convention,

(1) recognition and enforcement of an award may be refused, at the request of the party against whom it is invoked, only if that party furnishes to the competent authority where the recognition and enforcement is sought, proof that:

(a) The parties to the agreement referred to in article II were, under the law applicable to them, under some incapacity, or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made; or

(b) The party against whom the award is invoked was not given proper notice of the appointment of the arbitrator or of the arbitration proceedings or was otherwise unable to present his case; or

(c) The award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, that part of the award which contains decisions on matters submitted to arbitration may be recognized and enforced; or

(d) The composition of the arbitral authority or the arbitral procedure was not in accordance with the agreement of the parties, or, failing such agreement, was not in accordance with the law of the country where the arbitration took place; or

(e) The award has not yet become binding, on the parties, or has been set aside or suspended by a competent authority of the country in which, or under the law of which, that award was made.

(2) Recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition and enforcement is sought finds that:

(a) The subject matter of the difference is not capable of settlement by arbitration under the law of that country; or

(b) The recognition or enforcement of the award would be contrary to the public policy of that country.

61. See OECD, *supra* note 41, at 18.

62. *Id.*

tool for investors, the Russian judiciary should become more mindful of the jurisdiction and process of international arbitration.⁶³

A. Procedure for Enforcement of Foreign Arbitral Awards

According to the Russian Federation Code of Arbitrazh Procedure (CAP) enacted on September 1, 2002, arbitrazh courts “have the sole authority to decide whether foreign arbitral awards . . . [will be] . . . enforced.”⁶⁴ A request for enforcement should be made within three years of the date of the final award.⁶⁵ Arbitrazh courts then make a ruling regarding the enforcement of an arbitral award.⁶⁶ The court ruling can subsequently be appealed to the court of cassation, which can uphold the ruling, issue a new decision, or remand the case back to the initial arbitrazh court.⁶⁷ In rare circumstances it is possible to challenge the ruling before the Supreme Arbitration Court of Russia, which is the highest court in the commercial court system.⁶⁸ When a ruling on enforcement of a foreign award is made, the court issues a writ of execution.⁶⁹ The review of reported cases has not dispelled the view that Russian courts are less likely to enforce foreign arbitral awards than most of the “other signatory states to the NY Convention.”⁷⁰ Foreign arbitration awards were enforced in only about two-thirds of the reported cases, a figure that is significantly lower than the agreed international average of about ninety percent.⁷¹

63. *Id.*

64. Vladimir Khvalei & Jonas Benedictsson, *Recognition and Enforcement of Foreign Arbitral Awards in the Russian Federation*, 1 STOCKHOLM INT’L ARB. REV. 23, 25 (2005).

65. *Id.* at 26.

66. REYNOLDS, *supra* note 7, at 13.

67. Maxim Kulkov, *Enforcement of International Arbitration Awards in Russia*, RUSSIA/EURASIA COMMITTEE NEWSLETTER (ABA Section of Int’l Law), May 2007, at 5, available at <http://meetings.abanet.org/webupload/commupload/IC855000/newsletterpubs/RussiaMaynewsletter.pdf>.

68. *See id.*

69. *Id.* If the debtor fails to voluntarily execute the judgment, the bailiff service is used to attach and sell debtor’s assets. *Id.* Foreign investors should keep in mind that lack of cooperation by the bailiffs is a frequent problem. *Id.* at 7. Execution can be a very slow process if the collecting party does not monitor the process very carefully. *Id.* This similar issue is also encountered by foreign investors who use a domestic Russian arbitration tribunal. *See supra* notes 37-43 and accompanying text.

70. William R. Spiegelberger, *The Enforcement of Foreign Arbitral Awards in Russia: An Analysis of the Relevant Treaties, Laws, and Cases*, 16 AM. REV. INT’L ARB. 261, 262 (2005).

71. *Id.* The figure should be treated with caution though because it is possible that routine cases of enforcement are not published as frequently. *Id.* However, it is also possible that the rate is lower since there is no statistically reliable sample of published cases. *Id.*

[Vol. 10: 3, 2010]

PEPPERDINE DISPUTE RESOLUTION LAW JOURNAL

B. *Reasons Employed by Russian Courts in Refusing to Enforce Foreign Arbitral Awards*

This section of the article will analyze some of the problematic reasons employed by Russian courts in failing to enforce foreign arbitral awards. Russian courts are sometimes unwilling to recognize international arbitration awards but the grounds for rejecting an award are limited by the New York Convention.⁷² Therefore, Russian courts sometimes rule that recognition or enforcement of the award would be contrary to public policy.⁷³ In *Konditerskaya Fabrika A.V. K v. AVK.-Jug*, the trial commercial court refused to grant an application for enforcement of a foreign award because it ruled that recovering an amount in United States dollars from the debtor would contradict public policy since it would be contrary to Russian foreign exchange law.⁷⁴

In one notorious case, *United World Ltd. Inc. v. Krasny Yakor*, the Nizhny Novgorod Regional Commercial Court recognized and enforced a reward rendered by the International Chamber of Commerce (ICC) for the sum of \$37,600 plus accrued interest and legal fees.⁷⁵ However, on appeal the court of cassation sent the case back for retrial, because it ruled that the trial court failed to verify that the foreign award complied with public policy.⁷⁶ The court of cassation held that enforcement was counter to Russian public policy because it would lead to Red Anchor's bankruptcy and consequently adversely affect the regional economy and the Russian Federation as a whole.⁷⁷ Fortunately, public policy has not been applied in such an unusual way in many other cases, but "some courts tend to consider

72. Kulkov, *supra* note 67, at 6.

73. Khvalei & Benedictsson, *supra* note 64, at 39; New York Convention art. V(2)(b), June 10 1958 [hereinafter NYC]. Refusal on the basis of public policy is one of the most fiercely debated topics among Russian legal scholars. *Id.*

74. *Id.* (construing *Konditerskaya Fabrika A.V.K. v. AVK-Jug (Ukr. v. Russ.)*, Presidium of Russian Fed'n Supreme Com. Ct., No. 9772/01 (2002)). The judgment was later "annulled by the Presidium of the Russian Federation Supreme Commercial Court, which ruled that enforcement of a foreign arbitral award in foreign currency did not run counter to Russian foreign exchange legislation." *Id.*

75. *Id.* at 41 (construing *United World Ltd., v. Krasny Yakor (Pan. v. Russ.)*, Fed. Com. Ct. of Volga-Vyatka Cir., Case No. A43-10716/02-27-10isp (2003)).

76. *Id.*

77. *Id.* at 42. The cassation authority explained that the interest rate of 1.4% per month exceeded the maximum cap allowed in the Russian Federation. *Id.* at 41. In addition, the fact that the interest amount exceeded the amount of the initial principal violated the "principle of proportionality" of Russian law. *Id.* at 41-42.

contravention of mandatory Russian rules as contravention of Russian public policy.”⁷⁸ In *Falkland Investments Ltd. v. VBTRF OAO*, the court of appeal refused to enforce a foreign award against a Russian company that was undergoing bankruptcy proceedings because enforcement would contradict the Russian Federation Law “On Bankruptcy.”⁷⁹ The lesson for foreign investors is to carefully review contractual provisions to make sure that there is strict compliance with mandatory Russian laws.⁸⁰

Russian courts also deny enforcement of foreign awards on the grounds of procedural violations.⁸¹ Judges take a very formal approach in regards to evidence and are hesitant to accept emails, copies of documents that are not notarized, etc.⁸² In *Forever Maritime v. Mashimport*, “the court denied enforcement of the award on the grounds that the defendant was not properly notified of the time and place of the hearing.”⁸³ The court rejected evidence containing copies of the correspondence showing proper notification because the translation of the correspondence was not notarized.⁸⁴ In *Sophocles Star Shipping Inc. v. Technopromexport*, the Moscow Arbitrazh court and the court of cassation denied enforcement of the award because there was a mistake in the claimant’s name in the contract and the award itself.⁸⁵ The court found that the contract containing the arbitration clause used the name Sophocles Star Shipping Co., Ltd., while the request for enforcement was brought by Sophocles Star Shipping, Inc.⁸⁶ The foreign party had to appeal all the way to the Supreme Arbitration Court of Russia, which held that “the question of the agreement’s validity was beyond the scope of consideration” available under the enforcement procedures of the NY convention.⁸⁷

In some cases, Russian courts refused to enforce a foreign arbitral award because “the agreement to arbitrate was invalid or a party was under some

78. Kulkov, *supra* note 67, at 6.

79. Khvalei & Benedictsson, *supra* note 64, at 43 (citing *Falkland Inv. Ltd. v. VBTRF OAO*, Fed. Com. Ct. of Far Eastern Cir., Case No. F03-A51/01-1/2425-a (2001)). The court explained that enforcement would be counter to Russian public policy since according to Russian law any monetary claims against a debtor in bankruptcy proceedings may only be filed with the commercial arbitrazh court in the debtor’s region. *Id.*

80. Kulkov, *supra* note 67, at 6.

81. *Id.*

82. *Id.*

83. *Id.* (construing *Forever Maritime v. Mashinoimport*, Presidium of Russian Fed’n Supreme Com. Ct., No. 3253/04 (2004)).

84. *Id.*

85. *Id.*

86. *Id.* The arbitration agreement was held to be invalid since Sophocles Star Shipping, Inc. was not a party to the agreement. *Id.*

87. *Id.*

[Vol. 10: 3, 2010]

PEPPERDINE DISPUTE RESOLUTION LAW JOURNAL

incapacity.”⁸⁸ In *Euro Asian Investment Corporation v. Primorkhleboprodukt*, the Russian company OAO Primorkhleboprodukt (PMK) brought a cassation petition alleging that the lower court did not establish the legal status of Euro Asian Investment Corporation (EAIC).⁸⁹ The cassation court sided with PMK and may have required EAIC, the party seeking to enforce the award, “to prove the absence of a ground for non-enforcement instead of requiring PMK . . . to prove the presence of [incapacity].”⁹⁰ Investors should therefore anticipate that there is a “possibility that the court will misapply the burden of proof with regard to capacity of a party to enforce an award.”⁹¹ If the enforcing party is a foreign entity, it should prepare all corporate documents proving legal capacity and translate them into Russian.⁹²

In other cases, Russian courts rejected an award on the basis that “the composition of the arbitral authority or the arbitral procedure was not in accordance with the agreement of the parties, or, failing such agreement, was not in accordance with the law of the country where the arbitration took place.”⁹³ In *Pressindustria S.p.A. v. Tobolsky Neftehimichesky Kombinat*, an arbitral award was issued in Stockholm determining that the joint agreement should be terminated due to material breach by the Russian party.⁹⁴ However, the request for recognition and enforcement of the award in Russia was denied because the court ruled that the award contained resolutions that went beyond the terms of the founders’ agreement and its arbitration clause.⁹⁵ In *TBE Construction v. Usadba-Tsenty OAO*, one of the reasons given for refusing to enforce an award was the fact that the

88. Spiegelberger, *supra* note 70, at 283; NYC, *supra* note 73, at art. V(1)(a).

89. Spiegelberger, *supra* note 70, at 283 (construing EAIC v. Primorkhlebo produkt, Fed. Com. Ct. of Far Eastern Region, Case No. F03-A51/02-1/2178 (2002)).

90. *Id.* at 284. The ruling was made despite the fact that EAIC submitted a number of documents proving their legal status to the arbitration tribunal and the tribunal found the documents sufficient. *Id.*

91. *Id.*

92. *Id.* Foreign parties seeking to enforce an award should expect to have the Russian court and the opposing party carefully examine corporate documents for substantive mistakes or any omissions. *Id.*

93. NYC, *supra* note 73, at art. V(1)(d). See also Khvalei & Benedictsson, *supra* note 64, at 36-37.

94. Khvalei & Benedictsson, *supra* note 64, at 36 (construing *Pressindustria S.p.A. v. Tobolsky Neftehimichesky Kombinat (Italy v. Russ.)*, Presidium of Russian Fed’n Supreme Com. Ct., Case No. 2853/00 (2003)).

95. *Id.* at 36-37.

arbitration agreement required the proceedings to be conducted according to the rules of the Stockholm Chamber of Commerce with the place of arbitration in Moscow.⁹⁶ Instead, the arbitration tribunal held their hearings in Stockholm, Sweden.⁹⁷

As shown by some of the problematic cases referenced above, recognition and enforcement in Russia can present difficult hurdles to investors seeking to enforce foreign awards.⁹⁸ Some of these reasons can be hard to understand for Western legal practitioners and investors.⁹⁹ Russian courts tend to take a very formal approach, which can strike as self-serving.¹⁰⁰ The reason that it can be perceived as self-serving is because sometimes it seems that the court is deliberately using formal grounds to find an excuse for refusing to enforce an award. In some instances, “[m]aterial aspects of the case are factored in by Russian courts when dealing with formalities and in reaching decisions by which an application for recognition and enforcement is refused on formal grounds.”¹⁰¹ For example, the *Krasny Yakor* court seemed to deliberately confuse public policy with public interest.¹⁰²

Investors from United States or Western Europe might be puzzled by the formalistic approach that Russian courts tend to take. As evidenced by the various decisions previously discussed, Russian courts are determined to follow every rule precisely. A Western legal practitioner might try to argue that it makes no difference if the final hearing is held in Rotterdam or in Amsterdam, as was the case in *Quality Steel Inc. v. Bummash*.¹⁰³ However, this type of argument is likely to fall on deaf ears. The lesson for foreign investors is to pay attention to all the formalities when entering into an arbitration agreement and during the actual proceedings.¹⁰⁴ The enforcing foreign party should take extra care to make sure that all documents are certified and translated into Russian, that the right names are included, and

96. *Id.* at 37 (construing TBE Construction v. Usadba-Tsentr OAO, Russian Fed’n Supreme Ct., Case No. 5G01-142 (2001)).

97. *Id.* In *Quality Steel Incorporated v. Bummash*, one of the reasons given for the refusal to enforce an award issued by the Netherlands Arbitration Institute (NAI) was that the hearings took place in Rotterdam and not in Amsterdam, which was what the parties’ originally agreed to. *Id.* at 38 (citing *Quality Steel Inc. v. Bummash*, Russian Fed’n Supreme Ct., Case No. 43-G02-2 (2002)).

98. *Id.* at 45.

99. *Id.*

100. *Id.*

101. *Id.*

102. *Id.* at 41-42. The *Krasny Yakor* court refused to recognize an award in order to protect their region from undesirable financial repercussions. *Id.* See also *supra* notes 75-77 and accompanying text.

103. *Id.* at 38.

104. Kulkov, *supra* note 67, at 7.

[Vol. 10: 3, 2010]

PEPPERDINE DISPUTE RESOLUTION LAW JOURNAL

that procedural notifications are carefully followed.¹⁰⁵ Arbitrators unfamiliar with Russian law should seek advice before initiating proceedings against a Russian entity in order to minimize the likelihood of any unanticipated problems. There is a greater necessity to pay attention to all the formalities and any discrepancies between the arbitration proceedings and the laws of Russia than Western counsel might otherwise be used to.

IV. INTERNATIONAL ARBITRATION CLAIMS FILED AGAINST THE RUSSIAN STATE: IS THERE ANY CHANCE OF SUCCESS?

In July of 2004, the Russian oil company Yukos and its former chief Mikhail Khodorkovsky, once Russia's richest man, were charged with tax fraud.¹⁰⁶ Ultimately, Mikhail Khodorkovsky was imprisoned and Yukos' operating assets were acquired at auction by Russian state-owned companies.¹⁰⁷ The charges against Yukos and its chief operating officer, Mikhail Khodorkovsky, were largely seen as politically motivated.¹⁰⁸ Group Menatep Limited (GML), one of the largest foreign shareholders of Yukos stated that it would publicly challenge the legality of the auction.¹⁰⁹ In 2005, GML filed a "US \$28 billion arbitration claim against the Russian Federation under the Energy Charter Treaty (ECT) . . ."¹¹⁰ Subsequently, other foreign shareholders of Yukos in Spain and the United Kingdom filed arbitration claims.¹¹¹ GML filed the largest commercial arbitration claim

105. *Id.*

106. Noah Rubins & Azizjon Nazarov, *Investment Treaties and the Russian Federation: Baiting the Bear?*, 9 BUS. L. INT'L 100 (2008).

107. *Id.* "Russia's biggest, state-owned gas and oil company, Gazprom, and its state-owned oil company, Rosneft, grabbed the bankrupted Yukos assets . . ." Rachel Ehrenfeld & Alyssa A. Lappen, *Human Events*, AMERICAN CENTER FOR DEMOCRACY IN DEFENSE OF FREEDOM, http://www.public-integrity.org/article/invent_index.php?id=378.

108. *Id.*

109. See Nina Chestney, *GML Seeks Minimum \$28.3 Billion from Russia for Unlawful Seizure of Yukos Assets*, Apr. 11, 2008, FORBES, available at <http://www.forbes.com/markets/feeds/afx/2008/04/11/afx4879568.html>.

110. Rubins & Nazarov, *supra* note 106, at 100.

111. *Id.* See also Luke Peterson, *In Dispute: Has Russia Mastered the Judicial Side-Step?*, Apr. 10, 2008, FDI, http://www.fdimagazine.com/news/fullstory.php/aid/2350/In_Dispute:_Has_Russia_mastered_the_judicial_side-step_html (last visited Mar. 15, 2010). It is unknown whether there are other arbitration claims related to the Yukos matter since there is no requirement for such cases to be disclosed publicly. *Id.*

ever and its director Tim Osborne expects that damages will exceed US \$50 billion.¹¹²

One definition of corruption entails dealing with a matter for political or other reasons instead of the actual merits.¹¹³ The Yukos affair appears to have been the application of law for political reasons, a form of corruption.¹¹⁴ The Transparency International 2007 Global Report stated that there is widespread corruption in Russia and its courts in particular.¹¹⁵ Russian Minister of Economic Development and Trade German Gref admitted that “everyone knows the Taxation Service is corrupt.”¹¹⁶

Vladimir Gladyshev, a lawyer-diplomat who represented many Western and Russian companies in Russian courts, was interviewed about the effect of the Yukos affair on foreign investors.¹¹⁷ Gladyshev was quoted as saying that “So far, only a few foreign companies have been attacked with the use of technique developed during the Yukos case. So, if a foreign company has not fallen afoul of high political authorities, it does have a good chance in court.”¹¹⁸ In order to prevent similar takeovers, foreign investors should gather a lot of political support from their home country.¹¹⁹

The biggest worry for foreign investors is that there have been attacks on foreign businesses after the Yukos case. Russia has been employing various techniques such as tax fraud or environmental violation accusations to go after foreign owned investments in order to gradually nationalize sectors such as energy. The Russian government has an agenda to centralize and consolidate industries such as aluminum, steel, and most importantly energy.¹²⁰ Former President Vladimir Putin began consolidating Russia’s

112. Chestney, *supra* note 109. GML is claiming that the unlawful expropriation of Yukos assets led to Yukos bankruptcy and dissolution in 2007. *Id.*

113. Burger, *supra* note 43, at 15.

114. *Id.* at 30.

115. Ehrenfeld & Lappen, *supra* note 107. The report also indicated that the corruption in the court system can be attributed to the government’s growing political interference. *Id.*

116. *Id.* Russia uses its corrupt courts to legitimize the confiscation of private property by the state. *Id.*

117. Bruce W. Bean, *Interview: Foreign Investors Affected by Yukos Backlash*, RUSSIA/EURASIA COMMITTEE NEWSLETTER (ABA Section of Int’l Law), May 2007, at 8, available at <http://meetings.abanet.org/webupload/commupload/IC855000/newsletterpubs/RussiaMaynewsletter.pdf>.

118. *Id.* at 10 (quoting Vladimir Gladyshev).

119. *Id.* In fact, several attempted takeovers of foreign businesses after the Yukos case were stopped after high level diplomatic pressure. *Id.*

120. Ehrenfeld & Lappen, *supra* note 107.

A high-stakes battle for the direction of the Russian economy is creating new uncertainty, prompting investors and others to pull back. On the one side are Russian liberals, who favor rapid market

[Vol. 10: 3, 2010]

PEPPERDINE DISPUTE RESOLUTION LAW JOURNAL

energy industry in 2003 and he did not stop with Yukos.¹²¹ In September 2006, the Russian government revoked the Royal Dutch Shell (Shell) company license to manage the world's biggest liquefied gas development in Sakhalin.¹²² Shell was accused of environmental violations and forced to hand control of the US \$22 billion project to state-owned gas and oil entity Gazprom.¹²³ In June 2007, the Russian government went after international oil company British Petroleum (BP) and threatened to revoke its development license.¹²⁴ BP was forced to sell its 62.9% stake in the world's largest natural gas field in Kovykta to Gazprom for pennies on the dollar.¹²⁵ The issue for these foreign investors and companies is how to recoup their investments. The international arbitration forum allows them to file suits against the Russian state. However, the question is do they have any chance of success?

The answer is yes, but it will most likely be a difficult and lengthy process. First, investors will have to obtain a favorable arbitration judgment either through the benefit of investment protection treaties, the ECT, or another multinational agreement. Next, they would have to enforce and execute the judgment in a state arbitrazh court. If Russia fails to cooperate in the arbitration claims filed by foreign shareholders of Yukos,¹²⁶ investors will have to attach Russian owned assets abroad. As discussed previously, seizure of assets is a rather complicated process and investors would have to battle sovereign immunity laws in order to succeed.¹²⁷ However, investors

reform and merging with the world economy. On the other are the siloviki, ex-security men who want to build a state-guided economy.

Fred Weir, *Oil Booms, But Investors Flee Russia*, THE CHRISTIAN SCIENCE MONITOR, Apr. 12, 2005, <http://www.csmonitor.com/2005/0412/p01s02-woeu.html> (last visited Mar. 15, 2010).

121. *Id.*

122. *Id.* The Shell episode occurred after Vladimir Putin met with business leaders in March of 2005 to "[p]ledge that the seizure of Yukos would be the last episode of its kind." Weir, *supra* note 120. "He also promised to rein in Russia's tax collectors, who've been the *siloviki's* main instrument." *Id.* However, Putin's promise remains to be fulfilled since there have been multiple incidents after the pledge.

123. Ehrenfeld & Lappen, *supra* note 107. Vladimir Putin was quoted saying "how much longer do we have to tolerate this?" *Id.*

124. *Id.*

125. *Id.* BP sold their stake, which was estimated to be worth US \$20 billion for \$700-900 million. *Id.*

126. See Chestney, *supra* note 109.

127. See *supra* text accompanying note 59 (discussing the process of seizure and attachment of assets in the context of enforcement).

have been successful against the Russian state even in cases where Russia refused to cooperate.¹²⁸

A. Overview of Relevant Treaties

An analysis of the relevant treaties is required in order to better understand how foreign investors can recoup their investments. In addition to the NY Convention, Russia is also a party to a number of bilateral investment treaties (BIT), many of which contain provisions for the enforcement of arbitration awards.¹²⁹ The NY Convention expressly provides that it “shall not affect the validity of . . . bilateral agreements concerning the recognition and enforcement of arbitral awards entered into by the Contracting States . . .”¹³⁰ Therefore, BITs can supplement the NY Convention as long as there is no inconsistency, and can take precedence over domestic legislation if there is contradiction.¹³¹

BITs allow individuals and companies from each contracting state to submit international arbitration claims against another contracting state, if the actions by the host state contravened BIT standards of investment protection.¹³² Each investment treaty contains slightly different definitions of “investor” and “investment” but almost all “contain a prohibition on expropriation without adequate compensation, covering . . . indirect or ‘creeping’ expropriation that destroys investment value or has an effect on ownership rights through regulation or other means.”¹³³ However, relatively few investors have used international investment arbitration as a tool for filing claims against the Russian state.¹³⁴

The Soviet Union concluded its first BIT with Finland in 1989.¹³⁵ Russia had signed at least forty-five BITs by the time Vladimir Putin became President in 2000.¹³⁶ However, after Vladimir Putin became

128. See *infra* text accompanying notes 145-152 and accompanying text (describing cases of successful enforcement and execution of arbitration awards against the Russian government).

129. Spiegelberger, *supra* note 70, at 273.

130. NYC, *supra* note 73, at art. VII(1).

131. Spiegelberger, *supra* note 70, at 273.

132. Rubins & Nazarov, *supra* note 106, at 101. Treaties give investors the option to choose such arbitration forums as the World Bank’s International Centre for the Settlement of Investment Disputes (ICSID), the Stockholm Chamber of Commerce (SCC) or arbitration under the rules of the United Nations Commission on International Trade Law (UNCITRAL). *Id.*

133. *Id.* The treaties require the host states to provide “fair and equitable treatment” to qualifying investors. *Id.* In addition, the treaties restrain the host state from taking actions that undermine the reasonable expectations that produced the choice to invest. *Id.*

134. *Id.* at 102.

135. *Id.*

136. *Id.* at 103.

[Vol. 10: 3, 2010]

PEPPERDINE DISPUTE RESOLUTION LAW JOURNAL

President, the rate at which new BITs were signed dropped, and the Duma hardly ratified any investment treaties.¹³⁷ The Yukos affair did not motivate the Russian government to increase the ratification of investment protection treaties.¹³⁸ In fact, the possible exposure of the Russian state to arbitration claims under the ECT will probably make the ratification of new BITs an even rarer occurrence.¹³⁹

The ECT provides for a legally binding forum for foreign investments in the energy sector.¹⁴⁰ Russia signed but did not ratify the ECT in 1994.¹⁴¹ Russia signed the ECT because it wanted to encourage foreign investment in the energy sector.¹⁴² However, because Russia never ratified the treaty there is debate as to whether it is bound by the treaty's provisions.¹⁴³ GML argues that ratification is irrelevant because Russia is already bound by the treaty because by signing it they implied that foreign investments are protected from expropriation.¹⁴⁴

B. Current Issues Facing Foreign Investors in International Commercial Arbitration Against the Russian State

Russia has approached investment treaties and their ratification very cautiously, which has prevented some investors from successfully filing their claims against the Russian Federation.¹⁴⁵ One of the earliest investor victories against the Russian state was the case of *Sedelmayer v. Russian Federation*.¹⁴⁶ The claimant, Mr. Franz Sedelmayer, was a German citizen and owner of a business that trained and equipped police personnel.¹⁴⁷ In 1991, Mr. Sedelmayer entered into a joint venture with the St. Petersburg

137. *Id.* Ratification by the Duma is a prerequisite for the investment treaty to enter into force. *Id.* The BITs that were signed after 2001 either severely limited the scope of protection for investments, or required that claims be subject to arbitration only if all parties agree after the dispute arises. *Id.* at 104. The rapid decrease in new BITs was undertaken to avoid granting new privileges. *Id.* at 105.

138. *Id.* at 105.

139. *Id.* at 105-06.

140. Chestney, *supra* note 109.

141. *Id.*

142. *Id.*

143. *Id.*

144. *Id.*

145. Rubins & Nazarov, *supra* note 106, at 106.

146. *Id.* (construing *Franz Sedelmayer v. Russian Federation*, ad hoc Award (1998)).

147. *Id.*

police department, but in 1994 “President Yeltsin ordered the joint venture’s premises to be repossessed by the government.”¹⁴⁸ “Mr. Sedelmayer submitted a claim for ad hoc arbitration in Stockholm under the Germany-Russian Federation BIT of 1989.”¹⁴⁹ In 1998, the tribunal issued an award, despite six jurisdictional objections from the Russian side, ordering Russia to pay US \$2.35 million plus interest.¹⁵⁰ However, it soon became clear that Russia was not going to pay the award voluntarily.¹⁵¹ After several years of attempting to attach Russian assets overseas, Mr. Sedelmayer successfully attached the income streams from apartment complexes in Germany owned by the Russian state.¹⁵² The case serves as a good example of how to successfully win, enforce, and execute an arbitration award against the Russian government.

The first issue facing foreign investors filing arbitration claims against the Russian state is “the expansion of arbitration through MFN clauses”¹⁵³ Nearly all modern BITs include provisions that guarantee qualified investors MFN status.¹⁵⁴ In *Berschader v. Russian Federation*, two Belgian investors won a contract for the construction of a new Supreme Court in Moscow.¹⁵⁵ After the work was almost complete, Putin’s office annulled the contract with millions remaining unpaid.¹⁵⁶ “In August 2004, the Berschaders filed a claim against Russia at the Stockholm Chamber of

148. *Id.*

149. *Id.* The treaty had a narrow dispute resolution clause but it also included an additional protocol that expanded the scope to include disputes that arose from government actions, reducing the value of foreign investments. *Id.* at 106; see Germany-Russian Federation BIT, Protocol, art. 3., June 13, 1989.

150. *Id.* at 107. “The total amount due quickly mounted to nearly US \$10 million.” *Id.*

151. *Id.* Mr. Sedelmayer went after Russian state-owned assets in Western Europe but faced a lot of difficulties overcoming local laws on immunity of assets. *Id.*

152. *Id.* In another case, Swiss company Noga received a US \$800 million SCC arbitration award against the Russian Federation. Maxim Shishkin et al., *Noga Takes the Final Step*, KOMMERSANT, Jan. 15, 2008, http://www.kommersant.com/p842235/Noga_debt/ (last visited Mar. 15, 2010). The Swiss company searched for Russian sovereign assets for many years battling European sovereign immunity laws until they were finally able to freeze stock held by a Russian state-owned bank. *Id.*

153. *Id.* at 108.

154. *Id.* The clauses require the host state to provide qualifying investors any rights enjoyed by third-country investors, including rights provided for in another treaty. *Id.* An issue that arises, for example, is whether an investor from the United Kingdom, who may not arbitrate expropriation disputes under the United Kingdom-Russian Federation BIT benefit from a treaty that allows a Norwegian investor to arbitrate those kind of disputes. *Id.* Investment arbitration tribunals have not reached a consensus regarding this issue. *Id.*

155. *Id.* at 109 (citing *Berschader v. Russian Federation*, SCC Case No V, Award 21 (2006)).

156. *Id.*

[Vol. 10: 3, 2010]

PEPPERDINE DISPUTE RESOLUTION LAW JOURNAL

Commerce under the 1989 Belgium-USSR BIT” for US \$13.3 million.¹⁵⁷ The Berschaders argued “that the expansive dispute resolution clause of the Norway-Russian Federation BIT should apply . . . by operation of the MFN clause.”¹⁵⁸ However, the tribunal rejected the Berschaders claim because of lack of jurisdiction.¹⁵⁹ The tribunal found that the terms of the Belgian treaty were inadequately clear to permit the use of the Norwegian arbitration clause.¹⁶⁰

The decision in *RosInvest Co UK v. Russian Federation* complicated the resolution of this issue even further.¹⁶¹ In October 2005, RosInvest, the owner of US \$7 million of shares in Yukos, submitted an arbitration claim at the Stockholm Chamber of Commerce pursuant to the United Kingdom-Russian Federation BIT.¹⁶² RosInvest argued that the broad dispute resolution clause of the Denmark-Russian Federation BIT should apply by virtue of the MFN clause.¹⁶³ The tribunal accepted jurisdiction over the expropriation claim because they held that UK investors could benefit from the MFN clause under the Denmark-Russian Federation BIT.¹⁶⁴ The issue of expansion of arbitration through MFN clauses is still not sufficiently clear

157. *Id.* The Belgium-USSR BIT established jurisdiction only to disputes “concerning the amount or mode of compensation to be paid under Article 5 [on expropriation] of the present Treaty.” *Id.* (quoting Belgium-Russian Federation BIT, art. 10(1) (1989)). The *Berschader* tribunal concluded that the expropriation clause included in the treaty can only be invoked after a Russian court issued a decision confirming expropriation. *Id.* (citing *Berschader*, SCC Case No V, Award 21 at 155).

158. *Id.*

159. *Id.*

160. *Id.* The *Berschader* tribunal held that “An MFN provision in a BIT will only incorporate by reference an arbitration clause from another BIT where the terms of the original BIT clearly and unambiguously so provide or where it can otherwise be clearly inferred that this was the intention of the Contracting Parties.” *Id.* (quoting *Berschader*, SCC Case No V, Award 21 at 181).

161. *Id.*

162. *Id.* The treaty included a similar arbitration and MFN clause as the one in the Belgium-Russian Federation BIT. *Id.* The arbitrators in *RosInvest Co* also held that the expropriation claim could not be settled directly under the United Kingdom-Russian Federation BIT. *Id.* at 109-110 (construing *RosInvest Co v. Russian Federation*, SCC Case No V at 123 (2007)).

163. *Id.* at 110.

164. *Id.*

The tribunal focused on the wording of the treaty’s [Denmark-Russian Federation BIT] MFN clause, which granted to UK investors all superior third-party rights related to the ‘management, maintenance, use, enjoyment or disposal of their investments.’ The arbitrators reasoned that the right to arbitrate investment disputes must be considered part of the ‘use’ and ‘enjoyment’ of the investments in dispute.

Id. (citing *RosInvest*, SCC Case No V at 123).

since there are conflicting decisions. However, the lesson for foreign investors is to structure their investments in a way that allows them to benefit from investment protection treaties.¹⁶⁵ Investors should carefully examine the applicable treaties and consult a legal expert, especially if they are investing in industries that are known to be susceptible to harassment by the Russian government.

The second issue facing foreign investors relates to Russia's decision to sign but not ratify the ECT treaty. The resolution of this matter will be particularly significant for GML and other foreign shareholders of Yukos. The general rule is that obligations under a treaty do not take full effect until the treaty is ratified, but the general rule might not apply with respect to the ECT.¹⁶⁶ The reason is that Article 45(1) of the ECT states that "[e]ach signatory agrees to apply this Treaty provisionally pending its entry into force . . . to the extent that such provisional application is not inconsistent with its constitution, laws or regulations."¹⁶⁷ It would seem that Article 45(1) imposes some obligation on the signatory state since the treaty includes this unusual provision.¹⁶⁸ GML will argue that Article 45(1) makes the ECT provisionally binding on states that had signed but not yet ratified the treaty.¹⁶⁹ Therefore, Russia accepted the treaty's application when it signed it in 1994.¹⁷⁰ GML's main argument is that Russia signed the ECT to encourage investment in the energy sector and the move signaled that foreign investments would be protected from takeovers by the state.¹⁷¹ GML expects a ruling on the jurisdiction issue by June 2009 and a final decision

165. *Id.* at 113.

166. *Id.* at 110.

167. The Energy Charter Treaty, Art. 45(1), http://untreaty.un.org/unts/144078_158780/10/8/3517.pdf.

168. Rubins & Nazarov, *supra* note 106, at 111. However, the question remains if it has the same effect as if the treaty was already ratified. *Id.* The court in *Petrobart v. Kyrgyzstan* dealt with this question in passing. *Id.* In the case, the claimant filed a claim at the Stockholm Chamber of Commerce under the ECT but the company was incorporated in Gibraltar. *Id.* (construing *Petrobart v. Kyrgyzstan*, SCC Case No V (2005)). The issue was that when the United Kingdom signed the ECT, Gibraltar was included but when they ratified the ECT, the ratification instrument did not include Gibraltar. *Id.* The tribunal had to determine if Petrobart was a qualifying investor under the ECT. *Id.* The tribunal ruled that "Article 45(1) of the ECT meant that the signature document, with its reference to Gibraltar, was already sufficient for the treaty to enter into effect with respect to the United Kingdom, and that this accession remained in force indefinitely." *Id.* Therefore, it would seem that Russia would be subject to the arbitration provision of the ECT even though they had not ratified the treaty. *Id.*

169. Chestney, *supra* note 109.

170. *Id.*

171. *Id.*

[Vol. 10: 3, 2010]

PEPPERDINE DISPUTE RESOLUTION LAW JOURNAL

on damages by the end of 2012.¹⁷² GML has a good chance of getting the arbitration tribunal to rule that Russia is bound by the arbitration investment provisions of the ECT, despite the fact that the treaty has not been ratified. However, GML and other foreign investors in Yukos will probably have a difficult time enforcing the final arbitral awards against Russia.

The third issue that investors could face is that even if they can obtain a final judgment in their favor, voluntary payment of the award by the Russian state might not be forthcoming. “[T]here is little sign that the Russian Government has changed its recalcitrance with respect to arbitration awards rendered against it.”¹⁷³ The Russian state will probably attempt to delay payments for as long as possible by taking advantage of sovereign immunity laws and the inability of foreign creditors to seize state assets in Russia.¹⁷⁴ It is clear that GML’s road to recovery has a lot of hurdles along the way.

Nevertheless, the *Sedelmayer* case showed that it is possible to win and execute a final award against the Russian state.¹⁷⁵ It is difficult to predict when accusations of tax fraud or environmental violations will come up but investors should follow Russia’s political events closely to pick the right sectors to invest in pursuant to their risk strategy. Investment in the energy sector can be highly unpredictable based on what happened to Yukos, Shell, and BP.¹⁷⁶ Investors should protect themselves by structuring their investment in a way that allows them to file arbitral claims under investment protection treaties.¹⁷⁷ Investors should also fight back as quickly as possible if they find themselves in a position where their investment has been expropriated. They should gather as much public support at home as

172. *Id.* The final decision can take even longer since there will likely be multiple appeals along the way. *See id.*

173. Rubins & Nazarov, *supra* note 106, at 112.

174. *Id.* *See also supra* note 59 (discussing the process of seizure and attachment of assets in the context of enforcement).

175. *See supra* notes 145-152 and accompanying text.

176. However, ConocoPhillips does not seem to be complaining after purchasing an 8% stake in Russia’s private oil company, Lukoil. Jason Bush, *Conoco and Lukoil: Everyone Wins*, BUSINESSWEEK, Sept. 30, 2004, available at http://www.businessweek.com/bwdaily/dnflash/sep2004/nf20040930_1931.htm. Conoco paid US \$1.98 billion for the stake, which is the largest investment by a U.S. company in Russia. *Id.* This shows that despite all the risks involved, foreign companies still want to invest in Russia. *Id.* Putin welcomed Conoco’s investment but, most analysts agree that investing in Russia, especially in the energy sector can still be quite unpredictable. *See id.*

177. Rubins & Nazarov, *supra* note 106, at 113. “Carefully examining the provisions of investment treaties in force and considering incorporation of project vehicles in appropriate jurisdictions have become an essential part of business planning.” *Id.*

plausible in order to exert diplomatic pressure on the Russian government.¹⁷⁸ Most importantly, they should file international arbitration claims and be prepared for a long battle. GML and other foreign investors will have to be persistent, use skilled lawyers, and hire investigators that can locate and attach Russian state-owned assets abroad.¹⁷⁹

V. CONCLUSION

Russia has made a lot of progress in many areas, including the legal and regulatory environment, since the collapse of the Soviet Union. However, recent actions by the Russian state detracted from investor confidence.¹⁸⁰ This article focused on a lot of the problems facing investors in arbitration against Russian entities and the Russian state. Nevertheless, that does not mean that there have not been plenty of successful arbitration claims. The purpose of this article is to provide investors with an understanding of the current issues so that they will be better equipped to structure their investments in a fashion that minimizes the likelihood of arbitration related hurdles.

Russia needs to address some vital concerns in order to make arbitration a more effective and reliable dispute resolution method. First, the Russian judiciary should become more mindful of the jurisdiction and process of international arbitration.¹⁸¹ This would require arbitrazh courts to apply the public policy doctrine in a consistent matter and to avoid using formal grounds as an excuse for refusing to enforce foreign arbitration.¹⁸² Second, Russia should improve the reliability of domestic arbitration. In order to achieve this, Russia needs to pass legislation that clarifies the jurisdiction of arbitral awards issued inside of Russia in which one of the parties is foreign.¹⁸³ Furthermore, Russia should revoke the current rule that requires every arbitration award to be enforced by an arbitrazh court.¹⁸⁴ In addition,

178. Bean, *supra* note 117, at 10.

179. See Rubins & Nazarov, *supra* note 106, at 112.

180. Russia has been using the application of law for political reasons, which is a form of corruption. Burger, *supra* note 43, at 30. See also *supra* notes 106-112 and 120-125 and accompanying text (describing Russia's recent actions in the energy sector).

181. OECD, *supra* note 41, at 18.

182. This should raise the enforcement of foreign arbitration awards closer to the agreed international average of about ninety percent. See Spiegelberger, *supra* note 70, at 262.

183. See *supra* notes 19-24 and accompanying text (discussing that the confusion in regards to which law applies stems from the fact that most international commercial disputes that are not arbitrated would be decided in arbitrazh courts and therefore would seem to be governed by the Temporary Statute).

184. "As with international arbitral procedures, the weakness in the system is in Russian enforcement of decisions." U.S. Department of State, *supra* note 2. The execution order can only be

[Vol. 10: 3, 2010]

PEPPERDINE DISPUTE RESOLUTION LAW JOURNAL

the court bailiffs service should become less dependent and more reliable in order to speed up the execution of favorable decisions.¹⁸⁵ Third, Russia should voluntarily pay arbitration awards rendered against it and stop the delay of payments by taking advantage of sovereign immunity laws.¹⁸⁶ If Russia takes these actions, it would be able to attract more foreign direct investment, which is vital to the long-term growth of its economy.

Arbitration can be an effective dispute resolution method despite all of the potential issues that investors might encounter along the path to recovery. However, foreign investors can eliminate or avoid a lot of the arbitration hurdles that they are likely to encounter if they take certain precautionary steps. Investors should review each contract they enter into to make sure that they are in compliance with all Russian laws and keep up to date with the constant changes.¹⁸⁷ Additionally, investors should pay attention to all the formalities when entering into an arbitration agreement and during the actual proceedings.¹⁸⁸ Extra care should be taken to make sure that all procedural rules are followed precisely. Furthermore, investors should structure their venture in a way that allows them to file arbitral

issued by a Russian court or arbitrazh court. REYNOLDS, *supra* note 7, at 107. *See also supra* notes 32-36 and accompanying text (describing the fact that compulsory enforcement of an arbitral award requires a court order) and *supra* notes 44-56 (discussing that most foreign investors still prefer to insert dispute resolution clauses that provide for international arbitration because there is a lack of trust in Russian courts). Russia should consider giving arbitration institutions like ICAC the ability to enforce their own awards.

185. *See supra* notes 37-43 and accompanying text (discussing that the problem with the bailiffs service is that the fact that they report to the Ministry of Justice and not the court, which can sometimes make execution a very slow unreliable process). Improvement of the bailiffs ability to execute judgments will also aid in the execution of foreign arbitral awards.

186. *See supra* notes 173-174 and accompanying text. Russia should also honor its promise to stop the application of law for political reasons and cease the employment of various techniques such as tax fraud or environmental violation accusations in order to expropriate foreign investments in certain key sectors. *See supra* notes 106-125 and accompanying text (describing Russia's employment of various techniques such as tax fraud or environmental violation accusations in order to expropriate foreign investments).

187. *See supra* notes 14-19 and accompanying text. Foreign investors should also try to participate in older and established arbitration tribunals such as ICAC and MAC and carefully draft arbitration clauses to minimize the likelihood of interference by arbitrazh courts. *See supra* notes 20-28 and accompanying text (describing the jurisdictional issues that can arise in international commercial arbitration taking place inside of Russia).

188. *See supra* notes 103-105 and accompanying text (articulating that there is a greater necessity to pay attention to all the formalities than Western counsel might otherwise be used to).

claims under investment protection treaties and fight back quickly and with persistence if they find that their investments have been expropriated.¹⁸⁹

The legal framework in Russia has been rapidly improving but there needs to be greater reliability to make direct foreign investment more attractive. Greater consistency in the process of arbitration is part of the restructuring that needs to take place. Russia offers vast investment opportunities because it has a well-educated, dynamic workforce and an abundance of natural resources. In order to meet its full potential though, Russia needs to develop a healthy business climate, which will in turn encourage rapid growth of foreign direct investment.

189. See *supra* notes 174-178 and accompanying text (analyzing how investors can protect themselves from expropriation by the Russian state); *supra* notes 145-151 and accompanying text (describing how to successfully win, enforce and execute an arbitration award against the Russian government); *supra* note 59 (discussing some of the issues associated with the process of asset seizure in the context of enforcement).