Financial institutions
Energy
Infrastructure, mining and commodities
Transport
Technology and innovation
Life sciences and healthcare

NORTON ROSE FULBRIGHT

The public policy exception in Russia: recent trends

Yaroslav Klimov
Partner, Head of Russia/CIS dispute resolution and litigation
Norton Rose Fulbright (Central Europe) LLP
14/11/2013

Historical background

- Violation of public policy - probably the most frequently used objection to the recognition and enforcement in Russia of foreign judgements and arbitral awards
- Historically, the public policy clause in Russia lacked precise definition as well as clear guidance on the terms of its application
- In December 2005 the Presidium of the Higher *Arbitrazh* Court of the Russian Federation ("**HAC**") approved the following definition of public policy:

  Russian public policy assumes *the good faith and equality of the parties entering into a private relationship, as well as a proportionality between the extent of the civil liability and the culpable wrong* (Information Letter No. 96)
- Russian courts have interpreted this clause very broadly

Examples of the broad interpretation of the public policy exception in enforcement cases

- *Konditerskaya fabrika v. AVK-Yug* – award made in USD was considered to be contrary to public policy of the Russian Federation due to the fact that payments in the Russian Federation are to be made in RUB (*Arbitrazh* Court of Kalmykia, decision of 15 August 2000, Case No. AC-460p/98)
- *Joy Lud Distributors International v. Moscow Oil Refinery* – enforcement was refused due to fact that the party claiming enforcement was named “Joy Lud Distributors International, Inc.” while the award was made in respect of “Joy-Lud Distributors International Inc.” (Federal *Arbitrazh* Court of Moscow District, decision of 17 March 2003, Case No. A40-64205/05-30-394)

Examples of the broad interpretation of the public policy exception in enforcement cases (continuation)

- *Sea Trading v. OJSC Elektronika* - enforcement was refused due to the fact that the translation of the letters notifying the party regarding place and time of arbitral proceedings was not notarized before being presented to the arbitrazh court and therefore the party was considered not to have been notified of the arbitral proceedings (Federal *Arbitrazh* Court of the Volgo-Vyatsky District, decision of 17 February 2003, Case No. A43-10716/02-27-10)
- *Stena RoRo AB v. Baltic Zavod* – the enforcement of an award was refused as it would negatively affect the strategic legal entity in the Russian Federation: the bankruptcy of the strategic entity might be considered as a risk to the security and defensive capacity of the state (Federal *Arbitrazh* Court of North-West District, decision of 24 April 2009, Case No. A56-60007/2008)

Statistics for 2005 - 2012

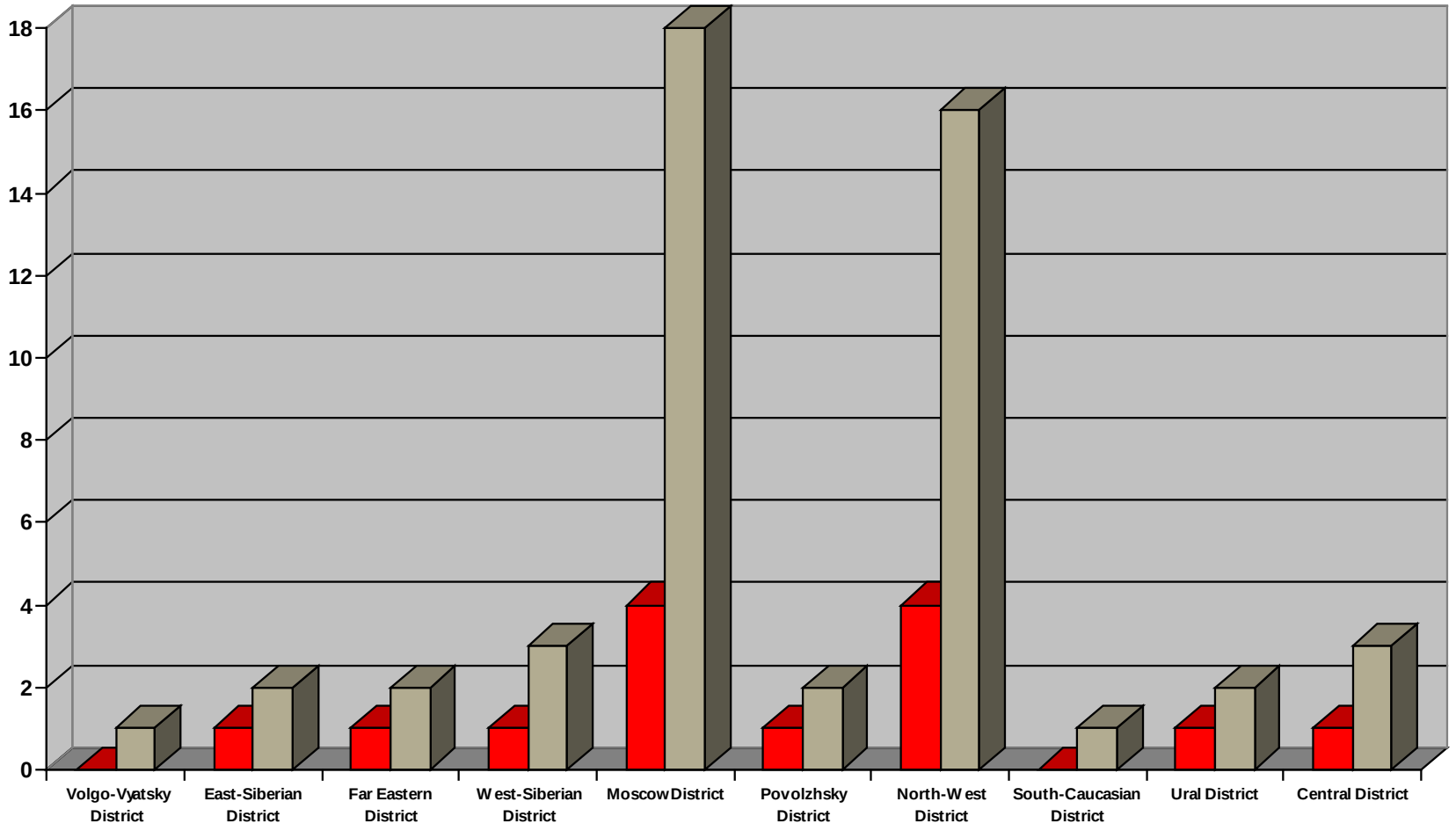
51 available cases on the enforcement of foreign arbitral awards decided by Federal *Arbitrazh* Courts of the Russian Federation were analyzed:

- In all of these cases the party that was against enforcement of the foreign arbitral award did raise an argument regarding contradiction of the enforcement of an arbitral award to the public policy of the Russian Federation
- In one fourth of cases the procedural grounds for refusal of enforcement of an award prescribed by the New York Convention were confused with contradiction to the public policy as the ground to refuse enforcement; but for the parties such confusion did also appear in the *ratio decidendi* of the *arbitrazh* courts

The result:

- Federal *Arbitrazh* Courts refused the enforcement of a foreign arbitral awards in 14 cases (27 per cent) on the basis of contradiction to the public policy of the Russian Federation

Statistics for 2005 – 2012



NORTON ROSE FULBRIGHT

Recent practice review by HAC on the application of the public policy exception

- Initial draft practice review published on December 6, 2012 and approved on February 26, 2013 as a result of intensive discussion and follow-up amendments
- On April 1, 2013, the Information Letter No. 156 published on HAC website: *"Review of Arbitrazh Court Practice in Applying the Public Policy Exception as a Ground for Refusal to Recognize and Enforce Foreign Judgements and Arbitral Awards"* (the "**Review**")
- Summary of 15 years of relevant court practice / recommended to all *arbitrazh* courts to be used as a guidance
- 12 specific cases considered: only in two of them did the Russian courts support the conclusion that there had been a violation of Russian public policy
- HAC's legal positions on most of these cases included in the Review are aimed at narrowing the unreasonably broad interpretations of the public policy exception by Russian arbitrazh courts

New definition of public policy

- New definition is more narrow than that previously used:

Public policy means the fundamental legal principals that are most imperative, universal, of special social and public significance, and that form the core of the state's economic, political or legal systems. In particular, this includes actions expressly prohibited by the internationally mandatory norms of Russian law if such actions prejudice the sovereignty or security of the state, affect large social groups, or violate the constitutional rights and freedoms of individuals

New definition of public policy (continuation)

- Actions affecting large-scale social groups or violating the constitutional rights of individuals may no longer be automatically classified as violations of Russian public policy
- New definition no longer includes violation of such civil law principles as equality of parties, inviolability of property and freedom of contract. Previously, Russian debtors had often argued that the foreign court or arbitral tribunal had failed to follow these principles (as well as principle of legality) and had been able to prove that such violations were contrary to Russian public policy
- New definition is based on the concept that, in ruling on whether a violation of public policy has taken place, a Russian court cannot review an award or judgement on the merits of the case

Recent guidelines for application of the public policy exception

- The Review provides that the enforcement of an award rendered on the basis of foreign law does not violate Russian public policy merely because such relevant foreign law rules are unknown to Russian law or because Russian law treats the same situation differently (Paragraph 5 of the Review)
- The application of legal categories unknown to Russian law does not *per se* lead to a violation of Russian public policy
- Paragraph 5 refers to the case of breach by a Russian party of warranties and representations given in the contract

Recent guidelines for the application of the public policy exception (continuation)

- **Paragraph 6 shows that HAC:**

- acknowledged the permissibility of deviating from strictly compensatory civil liability, and at the same time
- preserved the broad scope of the discretion of the Russian courts to find imposed penalties excessive (which would allow for a finding that the enforcement of an award or judgement for the recovery of such penalties would be contrary to Russian public policy)

- **The award for the agreed amount of damages is contrary to Russian public policy, in particular:**

- if the account of damages is so abnormally high that it exceeds the amount which parties could have reasonably foreseen at the time of the conclusion of the contract; or
- if at the time of agreeing on the amount of damages there were clear indications of abuse of freedom of contract, for example, abuse of position

Recent guidelines for the application of the public policy exception (continuation)

- Failure by a foreign legal entity to comply with the proper procedure for approving major transactions provided for by its *lex personalis* is not evidence of a violation of Russian public policy, since the rules governing special procedures for approving major transactions serve to protect the shareholders/participants of such a foreign company and, therefore, violation of these norms cannot give rise to a violation of the rights of the other party under the transaction (Paragraph 8 of the Review)
- In other words, the breach of certain regulatory requirements by a foreign party to a dispute may only be invoked by the other party if such foreign regulatory requirements were intended to protect the rights of the party invoking the public policy defence

Recent guidelines for the application of the public policy exception (continuation)

- The court is to apply the public policy exception only in exceptional cases when no other special grounds for refusal to recognize and enforce a foreign award or judgment apply (paragraph 4 of the Review). This guideline is very important for Russian courts
- Paragraph 2 of the Review confirmed that the court may apply the public policy exception on its own initiative
- At the same time, the Review stipulates (in paragraph 3) that a party seeking to rely on the public policy defence bears the burden of proof in substantiating it. This is in line with the procedural principle that a party must prove the facts upon which it intends to rely

Recent guidelines for the application of the public policy exception (continuation)

- Breach of the principle of independence and impartiality of arbitrators violates public policy (the Review referred to a case where an arbitrator also served as an officer of a parent company of one of the parties), so in such cases recognition and enforcement of an arbitral award may be refused
- A typo in foreign judgement or arbitral award which does not change its substance and meaning may not be considered as a violation of Russian public policy

Truncated tribunal issue

A case on the arbitral award rendered by a truncated tribunal was excluded from the final text of the Review. The draft referred to a case where it was concluded that the rendering of the award by a truncated tribunal (following the death of the arbitrator in the course of the drafting of the award) violates the principle of equality of the parties and thus Russian public policy. Its removal from the final text of the Review is very positive

Old procedural tactics of public policy application still possible

- *O&Y Investments Ltd. v. OAO Bummash* – enforcing an award based on an agreement that Russian courts have previously deemed invalid is considered to contradict the principle that judicial acts of the Russian Federation "are of mandatory nature" and therefore, Russian public policy (Federal *Arbitrazh* Court of the Ural District, decision of October 12, 2005, Case No. F09-2110/05-S6)
- Obtaining a final Russian court judgement before the foreign arbitral award is rendered and blocking on this ground the later recognition and enforcement of such arbitral award still remains possible and would obviously be further used by Russian parties
- Rosgazifikazia litigations concluded in cassation instance in September 2013 (i.e. after publication of the Review) confirm this view

Conclusions

- The Review is focusing on a narrow interpretation of the concept of public policy / a broader interpretation of the concept of public policy is inadmissible
- The Review would hopefully facilitate the development of more acceptable Russian court practice in cases related to the recognition and enforcement of foreign arbitral awards and court judgments


NORTON ROSE FULBRIGHT

Disclaimer

NORTON ROSE FULBRIGHT