

Business in Russia – domestic instead of international arbitration

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On 10 December, the Supreme Court of the Russian Federation published its ruling in a dispute between the Uraltransmash (a manufacturer of, among other things, trams and military equipment, covered by Western sanctions since 2014) and the Polish company PESA Bydgoszcz. This ruling allows already initiated trials from international arbitration courts to be taken to Russian courts or to initiate them in Russia. The court cited the June 2020 amendments to the country's Code of Arbitration Procedure (CAP) on the exclusive jurisdiction of courts there to hear disputes involving local entities subject to foreign restrictions. In its ruling, it explained that the mere fact of imposing (any) "restrictions" adversely affects the company's reputation and interferes with the impartial determination of the case by the foreign court.

In May 2013, PESA Bydgoszcz and Uraltransmash reached an agreement on the joint production of tram cars in Russia and they also jointly implemented a contract for the delivery of 120 cars to Moscow. Due to the devaluation of the ruble in late 2014 and early 2015 and the relative price of Polish trams (the contract was signed in euros), Moscow collected and paid for only 60 of them. In May 2019, PESA filed a lawsuit against Uraltransmash for payment of €55.2 million at the Arbitration Institute of the Stockholm Chamber of Commerce (chosen to hear the dispute due to a clause in the contract). In May 2021, it issued a final judgement partially favourable to the Polish company. As a result, it is too late to transfer the arbitration process to Russia in this case.

Commentary

- The decision of the Supreme Court of the Russian Federation sets a precedent and clarifies how the recently introduced amendments to the CAP will be applied in practice. In fact, the mere unilateral statement of intent by a Russian entity (natural or legal person) subject to any restrictions, including sectoral sanctions hindering access to Western capital markets in particular, will be sufficient to transfer a dispute to the jurisdiction of the Russian Federation. It is not necessary to prove the existence of specific problems resulting from the restrictions. This also applies to agreements already signed that include clauses designating particular international arbitration courts for dispute resolution. In fact, Uraltransmash's lawsuit found its way to the Supreme Court after the company's complaint was rejected by three instances of domestic arbitration courts, which stated that the company, despite being subject to sanctions, participated in the process before the Arbitration Institute of the Stockholm Chamber of Commerce

freely.

- The amendments to the CAP were intended to help protect the rights of local entities, which in the Russian interpretation were deprived of the possibility of fair arbitration abroad due to sanctions (there were cases when a company subject to sanctions was denied the right to arbitration, could not hire lawyers or the arbitrator did not agree to participate in the process). However, the way the Supreme Court has interpreted the law de facto allows Russian entities that want to avoid a fair trial abroad or drag the case out over a long period of time, the possibility of committing abuses.
- The exclusive jurisdiction of Russian courts to hear disputes involving domestic sanctioned entities will also increase the risk for foreign contractors of doing business in Russia. This may result in some of them abandoning cooperation with local partners, as well as an increase in the costs of these transactions and the need for Russians to provide additional guarantees. Currently, over 500 Russian natural persons and over 600 legal entities, i.e. a significant proportion of the entities involved in international cooperation (including key companies such as Gazprom, Rosneft and Sberbank – all covered by sectoral sanctions), are subject to various Western restrictions. This list is gradually growing. The effectiveness of the ruling introduced by the Supreme Court is also questionable. A unilateral decision by an entity to transfer a dispute to Russian jurisdiction does not mean that international proceedings will be halted. Judgements of the Arbitration Institute of the Stockholm Chamber of Commerce (and those of most international courts) are recognised by the majority of countries, so it is possible to pursue one's rights by, for example, seizure of the debtor's foreign assets, while judgements issued in these circumstances by Russian arbitration courts will be very difficult to enforce abroad. A rather selective application of this law can therefore be expected. Most Russian companies intensively involved in cooperation with other countries and holding assets abroad will rather be interested in settling a dispute using international arbitration.
- The Supreme Court's decision is another instrument of state support for entities subject to foreign restrictions. Previously instruments include: natural persons subject to personal sanctions (which restricted their ability to travel) were exempted from paying taxes in Russia if they presented a document confirming that they remain tax residents of another country (without having to leave the Russian Federation), and companies in the arms sector were exempted from having to make their financial reporting public. Many companies also received financial assistance from the budget.