



HKIAC becomes the first foreign arbitral institution licensed under Russia's new arbitration legislation

On 4 April 2019, the Hong Kong International Arbitration Centre (*HKIAC*) became the first foreign arbitral institution to receive approval from the Council for Enhancement of Arbitration, an advisory body under Russia's Federal Law on Arbitration (the *Arbitration Law*). Following such approval, it is anticipated that the HKIAC will receive within 15 business days a Russian governmental permit to administer arbitrations, as required under the Arbitration Law. This has profound implications for the arbitration of Russia-related disputes involving foreign parties, and opens up new opportunities for users of arbitration in Russia and Asia.

The requirement to obtain a permit

The Arbitration Law (in effect since 1 September 2016) requires all arbitral institutions to obtain a Russian governmental permit,¹ absent which any arbitrations administered by an institution **would not be considered as an "institutional arbitration"**.² This is highly relevant because **post-M&A disputes in respect of Russian companies, including those arising from share purchase agreements, share pledge agreements and shareholders' agreements**, are categorised as "*corporate disputes*" under the Arbitration Law, and the Arbitration Law requires at a minimum that such disputes **are only eligible to be arbitrated in institutional arbitration**.³ The Arbitration Law also imposes other requirements on the arbitration of different kinds of corporate disputes, which will be explained further below.

While it has been argued that foreign arbitral institutions are not bound by the Arbitration Law and may administer arbitrations involving "*corporate disputes*" seated outside Russia even if they do not possess a permit, a conservative reading of the law suggests otherwise and the issue remains untested in courts. Accordingly, there is some risk that such a foreign award may run into difficulty when enforcement is sought in Russia.

To date, only two Russian arbitral institutions (the Arbitration Center at the Russian Union of Industrialists and Entrepreneurs, and the Arbitration Center at the Russian Institute of Modern Arbitration) have been granted a permit.

Against this background, the grant of the Russian governmental permit to the HKIAC (which is anticipated to follow shortly) is highly significant. It is a first step which opens the door for parties to submit certain kinds of disputes to a highly trusted international arbitration center with reduced enforcement risk in Russia, and puts the HKIAC in the position of being the leading foreign arbitral institution for handling Russia-related international arbitrations.⁴

¹ The "right to perform the functions of a permanent arbitral institution".

² The International Commercial Arbitration Court at the Chamber of Commerce and Industry of the Russian Federation (ICAC) is exempted from this requirement.

³ It has been argued that some post-M&A disputes, for example claims for the share purchase price and for losses caused by breaches of warranties, are not corporate disputes. However, absent any guidance on this from Russia's top courts, potentially any and all disputes that arise from share purchase agreements and/or shareholders' agreements in respect of Russian companies may be deemed corporate, no matter if such agreements are governed by Russian or foreign law. For further details see *Russian M&A Deals in the Context of the Arbitration Reform: Practical Guidance*.

⁴ To date, the HKIAC is the only international arbitral institution to have obtained the permit.

What Russia-related disputes can be submitted to the HKIAC under its permit?

Following the grant of the permit, the HKIAC will become eligible under Russian law to administer:

- arbitrations arising from certain categories of Russian “*corporate disputes*” (including, most importantly, those arising from share purchase agreements and share pledge agreements relating to Russian companies); and
- arbitrations seated in Russia arising from non-corporate commercial disputes.⁵

For most international commercial parties, this category of “*corporate disputes*” is likely to be more significant.

There are, however, various other disputes which the HKIAC is not eligible to administer, as a matter of Russian law.

First, the HKIAC is not eligible to administer purely domestic Russian disputes, whether corporate or not.⁶ This is because the Arbitration Law requires foreign arbitral institutions to establish local Russian branches in order to become eligible to administer domestic arbitrations, and the HKIAC has not established such a local branch.

Second, there remain categories of disputes that are non-arbitrable under Russian law. By way of example, these include:

- disputes concerning public law (e.g., disputes over privatisation of state property and invalidation of administrative enactments),
- disputes under state procurement contracts, and
- disputes concerning a Russian company deemed strategic under the country’s foreign strategic investment legislation.⁷

Third, for disputes arising from other kinds of corporate transactions (e.g. shareholders’ agreements), certain additional requirements apply. These additional requirements are further explained below.

The ongoing reform of arbitrations involving Russian corporate disputes

The Arbitration Law and the Arbitrazh Procedural Code of the Russian Federation (APK) provide that, with respect to other kinds of “*corporate disputes*” (including disputes arising under shareholders agreements relating to Russian companies), in addition to the requirement that the arbitration must be “*institutional*”, the following requirements must be satisfied:

- (i) the seat of arbitration must be Russia,
- (ii) the arbitration agreement must be signed by all parties to the dispute, the Russian target company and all its shareholders (even if such shareholders are not party to the shareholders’ agreement), and
- (iii) specialised *corporate arbitration rules* must be adopted and applied by the eligible arbitral institution administering the dispute.⁸

While requirements (i) and (ii) are a matter of contractual arrangement between the parties,⁹ requirement (iii) is not met by the HKIAC, since it has not yet adopted the specialised corporate arbitration rules compliant with the Arbitration Law.

That said, the Russian government is moving to relax the requirements. On 27 December 2018, important amendments were made to the Arbitration Law to remove requirements (ii) and (iii) for disputes arising out of shareholders’ agreements – however, these requirements continue to apply, as the equivalent provisions under the APK remain unchanged.¹⁰

⁵ Before the permit, the HKIAC was able to administer commercial arbitrations seated in Russia, but such proceedings would have been considered ad hoc rather than institutional. This is important because, under Russian law, to the extent procurement contracts involving Russian state owned-entities (under Federal Law No 223-FZ of 18 July 2011) are referred to arbitration in Russia, they are only eligible to be arbitrated in institutional arbitration.

⁶ A dispute is “international” if it relates to international economic activity, such as cross border transactions. The elements for whether a dispute is international is defined in the Law on International Commercial Arbitration (1992, as amended and restated in 2015). Depending on the availability of these international elements, both normal commercial disputes and corporate disputes may qualify as either domestic or international.

⁷ See our previous publications: *Russian M&A Deals in the Context of the Arbitration Reform: Practical Guidance*; *Russia: International Arbitration 2018* on iclg.com; *Delos guide to arbitration places, Chapter Russia*.

⁸ The Arbitration Law sets out very detailed requirements to such specialised arbitration rules, resulting in a very complex multi-party arbitration procedure. The corporate arbitration rules must provide for sharing of information about the dispute among all shareholders of the company, and enable other shareholders to intervene. Such rules have been developed by the ICAC and the two other Russian arbitration centers holding governmental permits.

⁹ It is noted that there may be practical difficulties with requirement (ii) where the target Russian company has many shareholders and/or where some of them are unwilling to be bound by the arbitration agreement.

¹⁰ Federal Law No 531-FZ dated 27 December 2018.

Pending further changes to the APK, definitive guidance from Russia's top courts, or the HKIAC's adoption of specialised corporate arbitration rules, the HKIAC's ability to administer arbitrations arising from this category of disputes would remain restricted.

The triggering of waterfall arbitration clauses

Since the Arbitration Law was adopted in late 2015, the users of arbitration in Russia have been anticipating that one or more foreign arbitral institutions may obtain the Russian governmental permit. This, combined with the generally strong preference of certain arbitration users to have arbitrations administered outside Russia, has led to the widespread use of so-called waterfall arbitration clauses in Russia-related cross-border M&A and financial transactions. A typical *waterfall arbitration clause* lists a number of foreign arbitral institutions in order of preference such that, if a dispute arises, the arbitration goes to the highest ranked institution on the list which holds a Russian governmental permit. The HKIAC has been included in many such clauses. This means that, absent successful applications for the Russian permit by other foreign arbitral institutions, disputes arising from many existing transactions may well be referred to the HKIAC.

What's next?

The HKIAC's popularity among the users of arbitration in Russia has increased significantly over the past few years due to the growing economic ties between Russia and Asia and the HKIAC's considerable efforts in the Russian market. The anticipated grant of the Russian governmental permit to the HKIAC and the incorporation of the HKIAC into waterfall arbitration clauses reinforces this trend and will no doubt result in increased use of the HKIAC's services by both Russian and foreign parties in the context of Russia-related international disputes. As things stand, the HKIAC represents a very good choice for these disputes given its neutrality and its market-leading status. Assuming further liberalisation of the Russian rules concerning arbitration of shareholders' disputes, the potential for HKIAC's use in Russia-related disputes can only increase further.

How Freshfields can help

Our firm's top rated international arbitration group combines strong arbitration practices both in Russia and in Hong Kong (with a combined team of over 20 arbitration practitioners on the ground), and offers in-depth expertise in both jurisdictions, making us uniquely suited to advise on Russia-related international arbitrations in the HKIAC. In Russia, we have been closely involved in the drafting and development of the Russian arbitration legislation, and regularly advise and represent Russian and foreign clients in Russia-related disputes in various fora. Our Hong Kong arbitration practice has represented clients in some of the largest arbitrations in the region, and we also maintain an active practice relating to the Belt and Road Initiative.

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