OECD Russia Corporate Governance Roundtable

ALTERNATIVE DISPUTE RESOLUTION MECHANISMS IN THE SECURITIES MARKET

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The purpose of this report is to provide background information to participants of the OECD Roundtable on Corporate Governance in Russia, organised for 25 and 26 October 2012 in Moscow, Russian Federation. Referring to the OECD Principles of Corporate Governance, the report analyses the situation in Russia with regard to the resolution of corporate disputes. It considers the traditional system of dispute resolution in the area of corporate law, represented by commercial (arbitrazh) courts, and two alternative systems: specialized courts for corporate disputes and arbitration tribunals. The report describes the advantages and disadvantages of alternative dispute resolution, and the risks and opportunities associated with the integration of such mechanisms into the current Russian system. It quotes examples from international practice, and offers various perspectives of improving the framework of corporate dispute resolution in Russia.

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1. Introduction

1. According to the OECD Corporate Governance Principle I. D., "supervisory, regulatory and enforcement authorities should have the authority, integrity and resources to fulfil their duties in a professional and objective manner. Moreover, their rulings should be timely, transparent and fully explained". It means that sound legal and regulatory framework supported by law enforcement agencies promotes the rule of law and good corporate governance practices in a country.

2. Shareholders, including minority shareholders play an increasingly active role in shaping corporate governance practices all over the world. Such shareholders are willing not only to own shares in a company, but also to influence the decision making process. Such a proactive attitude of shareholders inevitably leads to an increase in the number and complexity of corporate disputes. In addition, institutional investors are actively involved in financial market operations, representing individuals, the fate of whose pensions and money savings are largely dependent on the quality of the regulation of corporate relations. For this reason, jurisdictions strive to improve the quality of legislation and regulation in this area (Bouchez, Karpf, 2006).

3. This report focuses on the analysis of the situation in Russia in the resolution of corporate disputes[1]. Currently, the development of financial institutions in Russia is far ahead of the development of law, and therefore there are often situations in which an existing corporate dispute cannot be resolved properly. Not uncommon are cases in which parties to corporate relations are unable to protect their rights due to lack of adequate legal regulation or the unsuitability of law enforcement authorities to the new economic realities.

4. These practices are not fully aligned with OECD principle I. B., "the legal and regulatory requirements that affect corporate governance practices in a jurisdiction should be consistent with the rule of law, transparent and enforceable." In this case, according to the annotation to the OECD Corporate Governance Principle I. B., "mechanisms for parties...to protect their rights" should be provided. In this regard, the report analyses the current situation with regard to the resolution of corporate disputes in Russia, citing examples of international practice, and offers various perspectives of improving the existing corporate dispute resolution system.

2. Description of the judicial system in Russia

5. The judicial power of the Russian Federation consists of the Constitutional Court, the military courts, the courts of general jurisdiction and commercial courts. The commercial court system has been introduced for commercial disputes in order to reduce the burden on the courts of general jurisdiction, and in order to ensure timely consideration of economic disputes by competent judges. The fundamentals of commercial courts' operation are enshrined in the Federal Constitutional Law "On Commercial Courts in the Russian Federation" and the procedure for consideration of economic disputes by commercial courts is enshrined in the Commercial Procedure Code of the Russian Federation.

6. Most commercial courts consider disputes arising out of the economic relations between the parties, each of which carries out business activities. Until recently, the general courts occasionally received and considered cases related to corporate governance, with the participation of individuals (in the role of shareholders or parties to the contract in respect of the shares). However, in 2009 a number of amendments were introduced to the Commercial Procedure Code[2], including a new section, which places business disputes under the exclusive jurisdiction of commercial courts, even in cases where a party to the dispute is not an individual entrepreneur.

7. In accordance with article 225.1 of the Commercial Procedure Code, corporate disputes fall within the jurisdiction of the commercial courts. It includes disputes on the following corporate matters:

- disputes relating to the establishment, reorganization and liquidation of a legal entity;
- disputes relating to ownership of shares or stakes in the share capital of the company, and their encumbrance;
- disputes involving claims of damages caused to a legal entity or contesting corporate decisions;
- disputes relating to appointment, election, suspension, termination of the authority and responsibility of persons who are members of the governing bodies of the legal entity;
- disputes relating to the issuance of securities;
- disputes arising out of the activities of holders of the register of securities' owners, linked to the rights to shares and other securities; disputes with regard to convening a general meeting of members in the legal entity;
- disputes with regard to appealing the decisions of a legal entity.

Such a definition of corporate disputes is broad enough to imply that almost all corporate conflicts shall be referred to commercial courts, and therefore the jurisdiction of courts of general jurisdiction is almost completely eliminated.

8. The Commercial court system consists of 81 first-instance courts, 20 courts of appeal and 10 cassation courts (regional federal commercial courts), and the Supreme Commercial Court. The Supreme Commercial Court [SAC], on the one hand, performs supervision of the subordinate commercial courts and, on the other hand, acts as an independent authority. It also provides explanations on judicial practice and prepares the Resolutions of the SAC Presidium on individual cases. Despite the fact that in Russia such clarifications and resolutions are not formally a source of law, the findings contained therein are binding on the lower commercial courts. This, in particular, follows from the powers of the Supreme Commercial Court to annul the decisions of the lower courts on the grounds of "breach of uniformity in the interpretation and application of law by the commercial courts."

9. In Decree No. 1 issued on the 21 of January 2010 the RF Constitutional Court considered the provisions of the Russian Commercial Procedure Code relating to retrial of cases by commercial courts due to “newly established circumstances”. The Court confirmed that judicial acts that do not meet the criterion of uniformity of judicial practices developed, inter alia, subject to clarifications of the Supreme Commercial Court, should be reversed. This Decree is yet another step towards increasing the role of court judgments in the legal system of the Russian Federation, promoted by active operation of the Supreme Commercial Court, whose decisions have the force of precedent (Ivanov, 2010). This is achieved by including in the decisions of the Supreme Commercial Court a clause that the legal stance of the highest court in a given case should be mandatory when considering similar cases.

10. Thus, the decisions of the Supreme Commercial Court in specific disputes must be used by lower courts to resolve similar cases, and deviation from the practice established by the Supreme Court will be grounds for reversal of the relevant judgment of the Commercial court. It should be noted, however, that before a corporate dispute is considered by the Supreme Commercial Court, it must pass through all three lower court instances, such process taking from six months to two years.

3. Main difficulties associated with the consideration of corporate cases in Russian Commercial courts

11. There is no doubt that corporate disputes are among the most complex cases and should be resolved by judges of the highest qualification in the shortest possible time. Lengthy review of corporate disputes generally results, inevitably, in losses both to the company and to its shareholders.

12. As mentioned above, by virtue of article 225.1 of APC RF, all corporate disputes shall be settled by commercial courts. This implies that the commercial judges must have special competence to consider corporate disputes. Despite the fact that the complicated civil, tax or administrative cases considered by commercial courts created a solid base for the development of practical knowledge and skills of judges, the latter often have difficulty in considering corporate disputes. Also, while in the Moscow region there has been a rise in the professional level of Commercial judges in this area, in the regional Commercial courts the competency of judges remains at a lower level than is required for the resolution of corporate cases.

13. The lack of sufficient number of judges competent in corporate law leads to the situation that in the majority of commercial courts there are no special panels that would deal with corporate disputes (a special "corporate" panel of Commercial judges exists, for example, in the Commercial Court of Moscow). The fact is that all new claims that come to court are divided between judges of different panels depending on the characteristics of the case and the specialization of the judges. Thus, tax disputes are considered by judges specialising in tax law, administrative cases come before judges of the administrative panel, etc. However, corporate disputes are distributed among a wide range of judges. Consequently, even if one judge has more experience than his or her colleagues in handling such disputes and is familiar with the specifics of corporate conflict, the corporate disputes coming before the Commercial Court may well be delegated not to him or her but to other judges who may not have a specialist qualification in this area.

14. Another problem with commercial courts is that, when considering the key disputes, they may be subject to pressure in one form or another from large companies. This is especially a problem for commercial courts in the regions of Russia. The jurisdiction of corporate disputes is determined by the location of the company, i.e. where the company pays taxes and carries out its main business. In this situation, the local government can put pressure on the court to ensure the "favour" of a large taxpayer who is making a significant contribution to the local budget. In addition, the special status of such companies and the scope of their activities suggests that they have contacts in all relevant branches of government of the relevant Federation entity, and this also can negatively affect the impartiality of the court.

15. In some cases, the speed of considering cases by commercial courts is also inadequate for the pace of corporate disputes. Although in general the Russian commercial courts settle disputes faster than similar institutions in other jurisdictions (Internet interview with A.A. Ivanov, 2008; statistics on the jurisdiction and courts of Britain's Ministry of Justice, 2010; "The agenda for judicial reform: extending procedural terms", 2011), the practice of a special approach to cases requiring urgent consideration is not developed. This can create difficulties both for shareholders who, for example, cannot quickly obtain a decision in cases challenging the general meeting, resulting in the dilution of their stake, and for the companies themselves, which cannot promptly annul wrongfully implemented interim measures under the shareholders' claims. Part of the problem is the excessive workload on the commercial courts. The fact is that access to justice in Russia (due, largely, to its low cost), and the impunity of the parties who abuse their procedural rights, encourage bad faith plaintiffs who wish to delay recovery of their debt or annoy their opponent, to lodge claims even in cases when the outcome is clear in advance. Commercial courts, thus faced with the need to consider a large number of cases every day (for example, in Moscow, the load per judge is about 90 cases per month[3]), cannot meet the market need for rapid and competent settlement of corporate disputes.

Box 1. Corporate agreements

One of the weaknesses of the Russian judicial system is that new concepts or unusual legal constructions arising in the legislation or practices create confusion and difficulties for judges. It concerns, in particular, disputes arising out of shareholders agreements. Such agreements were not recognized by Russian courts at all before introducing appropriate amendments to the law on Join Stock Companies in 2009. Even after these changes to the legislation the courts are still reluctant to pronounce on lost profit for breach of such agreements. Moreover, as highlights Monastyrsky, they give a "certain conservative commenting on the limits of their [corporate agreements'] application and legal effect according to which they must not violate any mandatory rules of law or distort the corporative structure of the company" (Monastyrsky, 2011). Moreover, disputes out of shareholders agreements are often treated by the courts as corporate disputes that makes them non-arbitrable, as State commercial courts have exclusive jurisdiction over corporate disputes.

16. The stated characteristics of commercial courts are not consistent with the OECD Principle I. D., as the law enforcement authorities (in this case, the commercial courts) do not have sufficient resources to carry out their duties in a professional and objective manner, and the court decisions are not always timely. Existing weaknesses in the operation of commercial courts undermine the normal functioning of the corporate law institutions in Russia. The next section of the report outlines some ideas on how to overcome this problem.

4. Ways to improve the system for the resolution of corporate disputes in Russia

17. Improving the efficacy of corporate dispute resolution, is above all connected to the improvement of the system of commercial courts and, in particular, to overcoming the problems described in the previous section.

18. In the light of the OECD Principles, more attention should be paid to professional development and specialization of judges. It is proposed to create in commercial courts corporate panels composed of judges who specialize exclusively in corporate cases coming to the attention of the relevant court. Since corporate disputes have a very specific nature, the isolation of such judicial panels from considering other categories of disputes should not negatively affect the quality of consideration of corporate cases. But although the creation of specific panels for considering corporate disputes could have a positive impact on the professional level of judges, it would not be able to impact on the independence of judges. There remains a possibility that the judge of a corporate panel, being in the system of commercial courts and reporting to the Chairman of the commercial court of the relevant region, will be at risk of pressure, like any other commercial judge.

19. To avoid the risk of pressure on the court, it seems reasonable to modify the existing jurisdiction rules for corporate disputes, so that cases involving companies listed on the Stock Exchange would not be considered at their place of registration, but would be resolved by commercial courts of Moscow. However, for smaller companies, where the disputes would be objectively less complex, the rules of jurisdiction may remain the same. In this case, the large regional companies would have less leverage over judges hearing their corporate disputes. This measure, of course, will increase the costs of legal representation of the large companies in corporate disputes, but it is not too high a price for a tangible increase in the independence of the court. This innovation may cause certain complaints resulting from the fact that it can be interpreted as restricting access to justice, but since most large companies have an office in the capital, the disruption caused by this development would not be too burdensome for them.

20. However, these measures for improvement of commercial courts may not be sufficient to build a high-quality and functional system of resolving corporate disputes in Russia. Parties to disputes are interested in fast, low-cost and high-quality resolution of the conflict, so it is important to provide them with other methods as an alternative to the commercial court. International practice suggests, in this case, the two most common alternatives - a specialized court to resolve corporate disputes (the "corporate dispute court") and arbitration tribunals[4]. Each of these alternatives is discussed in chapters below. There are also other mechanisms, such as mediation, but they are not considered in this report.

5. Corporate dispute courts

21. The obvious advantage for creating a corporate dispute court would be that this institution would fully specialize in corporate cases and have the appropriate judges. As the corporate dispute court is a part of the State court system, its decisions are enforceable without the need for any additional procedures. However, the State shall be responsible for financing the corporate dispute court, making it dependent on the State and, as a result, on companies with State participation, as well as on the structures close to the State.

5.1. International practice

22. There are instances in global practice when a State review of corporate disputes falls within the exclusive jurisdiction of a specialized court, and courts of general jurisdiction are not allowed to resolve corporate disputes. Examples include the Delaware Court of Chancery, Commercial Court of the Netherlands, Specialized Financial Court in the City of Almaty, and the Dubai International Financial Centre Court.

5.1.1. Delaware Court of Chancery

23. The Delaware Court of Chancery was founded over 200 years ago as an ordinary court of equity. Only in the twentieth century did this Court develop a broad practice in resolving corporate disputes in connection with the growing popularity of the State of Delaware as the place of registration of US companies. All corporate disputes of Delaware-registered companies are referred to the Delaware Court of Chancery. The indisputable benefit of this Court is the speed of hearing the cases - even the most complex case can be resolved within 7-10 days from the moment it is filed (Jacobs, 2006), and the judge, at his or her discretion, can put on the exigent list an urgent matter that requires immediate attention. This speed of case consideration is provided by narrowing the court's jurisdiction -the Delaware Court of Chancery does not consider criminal cases, family disputes, general civil disputes, etc.- as well as by having a single judge review all cases, without forming a jury (exceptions to this rule are extremely rare). Decisions of the Delaware Court of Chancery are appealed at the Delaware Supreme Court.

24. Because the Delaware Court of Chancery has unquestioned authority in the resolution of corporate disputes, and its decisions often became a reference point for other U.S. courts when considering similar situations, while also generating new approaches to corporate governance, which had a major impact on the development in the area of corporate relations in the US[5].

5.1.2. Commercial Court of the Netherlands

25. The Commercial Court of the Netherlands is a division of the Amsterdam Court of Appeal, which specializes in corporate and commercial disputes arising between companies registered in the Netherlands. Within its jurisdiction fall disputes challenging the decisions of a company's management, financial reporting, liability of management, etc. As with the Delaware Court of Chancery, the Commercial Court of the Netherlands is able to speedily make decisions on interim

measures and promptly review the disputes submitted to it for consideration. A distinctive feature of the Commercial Court of the Netherlands is its ability to conduct "investigation of the company activities". If a shareholder or group of shareholders holding more than 10% of the company or a large holder of its bonds doubts the correctness of management decisions taken by the company, they can ask the court to conduct an "investigation" of its activities. In cases where the Commercial Court of the Netherlands sees such a need, it can engage auditors who will have full access to all the documents of the company and must check its activities. A progress report is provided to the court which, should any breaches be ascertained, holds the company's management liable for improper management.

26. The Commercial Court of the Netherlands is not a court of last resort; its decisions can be appealed to the Supreme Court of the Netherlands.

5.1.3. Specialized Financial Court in Almaty

27. The first financial court in the territory of the CIS was established in Kazakhstan as part of the project to create the Regional Financial Centre of Almaty (RFCA). In 2006, by Decree of the President of the Republic of Kazakhstan, a specialized financial court was established in Almaty (fiscal court), with the jurisdiction to decide civil disputes of RFCA participants. Under Parts 1-4 of article 30 of the Civil Procedure Code of the Republic of Kazakhstan, the Specialized Financial Court hears civil cases involving property or non-property disputes of a member of the regional financial centre, as well as civil cases on the restructuring of financial institutions and entities that are a part of the banking conglomerate as parent entities and are not financial institutions. By creating this structure, Kazakhstan has demonstrated to the international investment community its ambition to achieve the skilled and impartial protection of the rights of the financial centre members. taking into account the specifics of the stock market and financial services.

28. The Financial Court's jurisdiction is extraterritorial in nature, covering the entire territory of the Republic of Kazakhstan, regardless of the scene of the disputed fact or the location of the respondent.

29. To make the financial centre attractive for investors (its main purpose is, in particular, to ensure the integration of Kazakhstan's securities market into the international financial market and the creation of favourable conditions for attracting investment), proceedings in the new court are held not only in Kazakh or Russian, but also in English. This achieves the main result - simplifying the proceedings as much as possible. Any foreign investor who wishes to register in the financial centre will be aware from the outset that in case of any disputes the proceedings can be conducted in English.

30. In this regard, the panel of judges, as well as court experts, consists of highly qualified lawyers who are fluent in English, many of them having had proper training abroad in the United States, South Korea, the UK and the Netherlands. A program of study abroad in the leading financial centres of the world, as well as organization of conferences and training seminars in Almaty with renowned judiciary figures from financial courts of the United Kingdom, Ireland, Malaysia and Singapore, have been developed specially for the Financial Court judges. Thus, a clear system of exchange of information has been established with foreign counterparts in developed countries, where the procedural experience in handling financial disputes is deeper.

31. Initially, the Specialized Financial Court of Almaty had the status of a regional court, the decisions of which could be appealed only to the Supreme Court of Kazakhstan (and the Supreme Court of Kazakhstan, as a rule, left unchanged almost all the decisions of the financial court). As a result of the reform of the judicial system in Kazakhstan in 2010, by Decree of the President of the Republic of Kazakhstan dated 29.12.1009 № 910 "On formation and elimination of some of the specialized courts of Kazakhstan", the Specialized Financial Court of Almaty, equated to a regional court, was abolished and replaced with the specialized Financial Court of Almaty with the status of a

district court. This increases the number of instances in which this financial court's decision can be appealed: now appeal, cassation and supervisory authorities, making the court highly dependent on the courts of general jurisdiction.

5.1.4. Dubai International Financial Centre Court

32. Establishment of the International Financial Centre in Dubai (Dubai International Financial Centre (hereinafter - the "Dubai IFC")), founded in 2004, required an amendment to the UAE Constitution. By Law No 8 (2004), the Dubai IFC was considered a free economic zone with its own civil and commercial law (based on English law), although at the same time it is subject to the criminal and administrative law of UAE, and the official language of Dubai IFC is English.

33. The Court of Dubai IFC is positioned as a whole independent judiciary system - DIFC Courts. It was created under two laws: Law No 12 (2004), which established the jurisdiction of this Court and the independent administration of justice in the Dubai IFC, and Law No 10 (2004), which recognized the powers, procedures, functions, and management of the Dubai IFC Court. Proceedings before the Dubai IFC Court are conducted in the English language.

34. Within the Dubai IFC Court there are only two instances: a case is heard by a single judge of the Court of Dubai IFC as a trial court, but the judge's decision may be reviewed on appeal in the same court by three judges with the participation of the Chairman of the Supreme Court or the most senior judge as chair. The Court of Dubai IFC has seven judges, two of whom are former British judges (the Commercial Court in London and the Court of Appeal of England and Wales), one judge from Malaysia, a former judge of the High Court of New Zealand, and two Arab judges, and the Dubai IFC Court is headed by a well-known legal expert from Singapore. In addition, in 2007 a small claims tribunal was created as part of the Dubai IFC Court, considering claims under 100,000 UAE Dirham (about $26,000).

35. By virtue of article 18 of Law No 10 (2004), when considering any case the Dubai IFC Court may involve one or more independent experts (assessors), who are highly qualified on the subject of the case. In making a decision based on the assessor's opinion, the judge should make clear in his or her decision which recommendations of the expert assessors were taken into account when making the decision, and to what extent.

36. The jurisdiction of the Dubai IFC Court covers all disputes relating to private and public bodies operating in Dubai IFC, transactions where the performance or result are at least in part connected with the territory of Dubai IFC, and cases for compensation of damages. In addition, the court considers any other statements by direct reference to the jurisdiction of the Dubai IFC Court in legislation, and also the acts of the public agencies of the Dubai IFC can be challenged in the first instance of the Dubai IFC Court, although it does not have jurisdiction in criminal cases. The appeal instance of the Dubai IFC Court hears appeals against decisions made by the Dubai IFC court of first instance, and interprets the laws in force in the Dubai IFC, with this interpretation having the force of law. The decisions of the Court of Appeal of Dubai IFC cannot be revised (Rozhkova, Afanasiev, 2011).

5.2. Proposals to create a corporate dispute court within the International Financial Centre

37. The issue of creating a specialized court in Russia has already been raised. Moreover, the RF Government Resolution of 11.07.2009 No 911-r "On the Plan of action to create an international financial centre in the Russian Federation", as one of the measures aimed at creating an international financial centre in Moscow (hereinafter - "MIFC") provided for "the *establishment of a specialized financial court in the structure of the commercial courts."* Although the plan was to be executed by

September 2010, and the creation of a financial court at MIFC has been actively discussed in legal circles[6], there are still no specific legislative proposals.

38. Since MIFC does not imply membership, the financial court at MIFC, even if it were created, could not follow the example of the Regional Financial Centre of Almaty and the courts of Dubai International Financial Centre and consider only the disputes to which a MIFC member is a party. This undoubtedly creates some uncertainty regarding the possible subjective jurisdiction of such court. The chairman of the Supreme Commercial Court of Russia A.A. Ivanov also drew attention to this problem, when asked about the prospects of creating a financial court at MIFC:

39. "This has been discussed, but we have not yet found room for such a court in the concept, and it is difficult to determine the range of cases to be considered there. If the financial centre were created as a kind of area with membership, then of course [this would be the case]. But so far the organizers are not planning any strict membership, so it is impossible to determine the scope of persons who will be litigating under the special procedure.

40. The following questions caused the most discussion: what types of disputes would be considered in such a court and what groups of persons would be able to go to this court? The Ministry of Economic Development wished for disputes between individuals to be considered by this court as well. If this proposal were passed, it would be impossible to predict how many of these cases would have ended in this court. One can assume that it could have become quite popular and would have a lot of cases, not to mention the fact that all the citizens of Russia would be able to go before such a court, even with the most basic disputes that could be resolved in their region. All this would have very quickly led to a significant decrease in access to justice" (Interview with A. A. Ivanov, "The Court of Finance", 2011).

5.3. What to consider when creating a corporate dispute court in Russia

41. Since the establishment of a corporate dispute court is aimed at creating a more effective way of resolving corporate disputes, the disadvantages of the existing system of corporate conflict resolution by commercial courts should be taken into account.

42. First of all, one needs to determine what should be the object competence of the corporate dispute court. Will it consider exclusively corporate disputes, or will it also be able to make decisions on disputes arising in the financial market, to consider the requirements for recognition and enforcement of foreign judgments and arbitral awards and other issues? Thus, it is necessary to determine whether the corporate dispute court shall have exclusive competence on these issues, or, as in the case of financial courts in international financial centres, its services will be available only for certain categories of persons (e.g. IFC members, if the appropriate IFC has a membership structure), while other disputes will be considered by the commercial courts.

43. One must also define the requirements with respect to the judges of the court to be created. International practice shows the need to engage lawyers who not only possess extensive knowledge in the legal field and judicial experience, but who are also fluent in international practice and speak foreign languages. It also seems necessary to include programs to maintain the high qualifications of judges in the corporate dispute court. It is important to determine how many judges will be needed and from which areas they need to be recruited (the judiciary, the Bar, legal experts, corporate lawyers, etc.).

44. A set of measures should be developed to accelerate the proceedings in the corporate dispute court. Attention can be given to such methods as providing the judges with the opportunity to determine the priority of cases, not to exceed the reasonable burden on judges (probably by the expansion of the court panel), and the reduction of bodies that oversee court decisions on corporate

disputes. Thus it is necessary to determine whether the decisions of the corporate dispute court will be reviewed by any court from the commercial court system, or whether another system will be created for appealing its decisions, separate from the commercial courts.

45. Finally, it should be noted that creation of an independent corporate dispute court in Russia will require significant changes in the law and is likely to come up against the resistance of the commercial courts, which are already a type of specialized court for the resolution of commercial disputes and may not be prepared to share power with the new structure.

6. Consideration of corporate disputes by arbitration

46. Unlike the corporate dispute courts, the arbitration tribunals should ideally be independent of the State and equidistant from all the participants of corporate relations, ensuring their independence and impartiality. This result is achieved because the arbitration tribunals are funded through the arbitration fee paid by participants in the proceedings, and do not receive money from third parties. The professionalism of the arbitrators shall be ensured by the right of the parties to appoint their arbitrator who, in the opinion of the party, must have a sufficient level of professionalism to make a decision in the case. Disputes shall be referred to an arbitral tribunal pursuant to an agreement of the parties to the dispute (arbitration agreement). Such an agreement may be entered into both before and after the dispute; the arbitration agreement is sometimes included in the corporate documents of the company, and all shareholders are bound by its terms.

47. However, the main advantage of arbitration tribunals, namely, no connection to the State courts, is also their serious shortcoming. Arbitral awards must be performed voluntarily by the parties, and if they are not performed, then one can enforce such award only by appealing to a State court. Firstly, this delays the resolution of corporate conflicts, and secondly, creates a risk of failure in the enforcement of the arbitral award, which can make the arbitral award unenforceable.

48. In addition, the contractual nature of arbitration is a drawback of arbitration tribunals in relation to the consideration of corporate disputes. In the absence of the consent of all parties to the dispute to be heard in arbitration, the arbitral award can easily be challenged in a State court. But if the consent of the parties to a shareholders' agreement or a joint venture agreement is evident in the inclusion of the arbitration clause in the text of the agreement, it is not easy for the arbitration clause to encompass all the members of a public company. Even the inclusion of the arbitration clause in the charter of such company does not give a guarantee that purely the fact of acquisition of the company's shares by a shareholder will be seen by the State courts as the shareholder's consent to the resolution of a corporate dispute with such a company in an arbitration court. Certain difficulties in this regard are created by the current practice of the Supreme Commercial Court, which does not recognize the shareholder as a party to the arbitration agreement contained in the company statute, because that person became a shareholder only after the arbitration clause was included in the company statute (Resolution of the Presidium of the Supreme Commercial Court on May 31, 2005, in case number 11717/02). As a result, many disputes involving public companies may be considered not arbitrable or arbitration clauses may be deemed not concluded.

6.1. Arbitration in Russia and creation of the arbitral tribunal at the Moscow Stock Exchange

49. The widespread use of arbitration for the resolution of corporate disputes is encompassed by the "Strategy of development of the financial market of the Russian Federation until 2020" approved by the Decree of the Government of the Russian Federation of 29.12.2008 No 2043-r, which, among other things, quite objectively describes the shortcomings of the current system:

50. "The problem of corporate conflicts between Russian companies, as well as disputes involving foreign investors, is pressing. The judicial procedure for resolving such conflicts and

disputes cannot bring conflicting parties to a relatively rapid and mutually acceptable way out of the conflict situation, due to its long duration and low efficiency. Litigation lasting many years causes increased costs to Russian companies, direct and indirect harm to investors and reduces the investment attractiveness of the Russian economy.

51. It is therefore necessary to support out-of-court forms of resolving corporate and other conflicts, to encourage the submission of disputes to arbitration tribunals, including those created by self-regulatory organizations, and to consider the application of the new method of seeking solutions and ways out of crisis situations for the Russian business practice: mediation. The advantages of this method include confidentiality, efficiency of the dispute consideration and the low cost, and there is no need to enforce the decision, as in the course of conciliatory procedures the parties themselves produce a decision that is satisfactory for them, and so are interested in its enforcement."

52. However, after four years from the adoption of the Concept there has been virtually no progress in promoting the arbitration tribunals as a means of resolving corporate conflicts. Moreover, the existing practice of commercial courts endeavours to ban the transfer of corporate disputes to arbitration.

53. Some attempts to change the situation are currently taking place within the IFC working groups. In particular, the creation of the Moscow Arbitration Court at the stock exchange is actively discussed, which, with the organizational assistance of the Exchange, would consider corporate disputes between listed companies. In particular, the following issues could be transferred for consideration by such an arbitration tribunal:

- issues based on the claims of the shareholder/s towards the controlling shareholder for damages caused by the controlling shareholder to the issuer as a result of control of the issuer or as a person interested in the transaction,
- issues based on the claims of the shareholder/s to the controlling shareholder for damages caused by the shareholder/s (due to the compulsory redemption, mandatory offer, etc.), as well as the requirements of the shareholder/s to the controlling shareholder and the persons jointly liable with him, related to the offers of the controlling shareholder, provided by the Listing Rules governing the premium segment (namely, claims for the recovery of funds for shares transferred under the offer, in relation to the obligation to buy back shares of the relevant shareholder(s) as part of the offer, for compensation of damages caused by defaults on the offer obligations)
- issues based on the claims of the shareholder/s to the issuer for compensation of damages caused to the shareholder/s.

This arbitration Court is envisaged to follow the model of Market Arbitration Panel at BOVESPA.

6.2. Experience of the Market Arbitration Panel at the stock exchange in Sao Paulo

54. Novo Mercado, the premium segment of the stock exchange BVSP (BOVESPA) in Sao Paulo, has set an example of what measures should be taken by the exchange to ensure the consideration of disputes by an arbitration tribunal. The Market Arbitration Panel is a classic arbitration tribunal at the stock exchange. The panel of arbitrators is appointed by BOVESPA and includes representatives of various professions: lawyers, economists, accountants, and former participants of the securities market.

55. Under the rules of BOVESPA, companies whose shares are quoted on the stock exchange, as well as their shareholders owning a controlling interest, the members of the executive bodies and members of the company board of directors, shall resolve disputes in the Market Arbitration Panel and follow its rules.

56. In accordance with Clause 3.1 [iv] of the BOVESPA Listing Rules, one of the main requirements for the placement of securities is *"introducing changes to the company statute so that the provisions of the statute meet the minimum set of requirements established by BM&FBOVESPA for statutes, including the requirement of the arbitration clause"*.

57. The clause states that "BOVESPA, the Company, the controlling shareholder, senior executives and members of the financial council undertake to turn to the Market Arbitration Panel in the event of any dispute relating to these Listing Rules, the agreement with the Novo Mercado and the arbitration clause, in particular, associated with their execution, validity, interpretation, breach and similar issues to resolve the dispute in accordance with the Arbitration Rules of the Panel."

58. It should be noted that the listing rules and all the corporate documents that must be signed by the company, members of management bodies and shareholders, contain the arbitration clause so that the consent of the said persons to apply to the Arbitration Panel is enshrined in several sources at once. For example, before the inclusion of shares in the quotation list, a company must adhere to the rules of arbitration, for which the Company shall provide a Statement of Consent (including the arbitration clause), signed by all senior managers, controlling shareholders and members of the board.

59. Even after the listing procedure, the company must ensure that the arbitration clause applies to all the new top managers and majority shareholders. For this, the inauguration of each manager or senior member of the board is conditional upon the signing of the relevant Statement of Consent. Moreover, the company will not approve the disposal of shares that entails the transfer of control over the Company until the person acquiring a controlling stake signs the Statement of Consent.

60. The adoption of these measures ensures that the arbitral tribunal has jurisdiction over all disputes arising in the company. In particular, the Market Arbitration Panel considers disputes related to challenging the legality of meetings of shareholders/board of directors, observance of the law or the rules of Novo Mercado, the interpretation of the provisions of the statute, corporate procedures with regard to directors / managers / owners of the controlling stake and other corporate matters and issues related to the stock market.

61. Investors who purchase shares traded on the BOVESPA stock exchange obtain a guarantee that no disputes will be submitted to the Brazilian courts of general jurisdiction. However, from 2007 to date, little more than 20 disputes were submitted for the consideration of the Market Arbitration Panel (and none of the decisions was reversed by the State courts). Such a modest number of cases stems from a specific attitude to the resolution of corporate conflicts in Brazil, where the vast majority of disputes are referred for determination to the market regulator, acting as a mediator.

6.3. Arbitrability of corporate disputes

62. The development of arbitration dispute resolution in countries with transition economies is often at a very low level (Bouchez, Karpf, 2006), and often this is due to the desire of State courts to retain their monopoly for consideration of the relevant disputes. Such a monopoly is established primarily by limiting the arbitrability of various disputes and a broad interpretation of the law in judicial practice. Russia is no exception here. In such a situation, the prohibitions established by judicial decisions can be overcome through the adoption of amendments to legislation that would recognize the arbitrability of certain categories of disputes.

63. Federal Law "On International Commercial Arbitration" and the Federal Law "On arbitration tribunals of the Russian Federation" provides that civil disputes may be transferred to the arbitral tribunal. Corporate disputes are usually attributed to the general civil disputes, as evidenced, in particular, by the provisions of the draft federal law "On amendments to the Civil Code of the Russian Federation", which specifically identifies corporate relations in the subject of the regulation of civil

law. Thus, the specific legislation governing arbitration in Russia does not contain restrictions on the arbitrability of corporate disputes.

64. Restrictions on the arbitrability of corporate disputes are sometimes seen in the content of Part 1 of article 248 of the APC, which States that "the following cases belong to the exclusive jurisdiction of commercial courts of the Russian Federation for cases involving foreign parties: <...> on disputes related to the establishment, liquidation or registration on the territory of the Russian Federation of legal entities and individual entrepreneurs, as well as challenges to the decisions of bodies of these entities. " However, because of the interpretation set out in the Decision of the Constitutional Court No 10-P of May 26, 2011, article 248 of the APC RF is aimed "at the division of powers of State courts of various countries in addressing cross-border disputes," and should not be used to limit the arbitrability of corporate disputes.

65. Currently, there is a real problem of interpretation by the courts of article 33 APC in conjunction with article 225.1 APC, which provides for special jurisdiction of corporate disputes to commercial courts. On January 30, 2012, by the Decision in the case No VAS-15384/11 (Maximov against NLMK), the Supreme Arbitration Court refused to review the decisions of the lower courts that interpreted article 33 APC and 225.1 as excluding the possibility of handing corporate disputes over to arbitration courts. The supreme court instance said that the International Commercial Arbitration Court at the RF Chamber of Commerce and Industry (hereinafter - the "ICAC") had not fully investigated the nature of the transaction that led to the claim, and this had led to incorrect conclusions regarding the competence of the arbitral tribunal. In making this decision, the Supreme Commercial Court either deemed the dispute non-arbitrable, since the agreement between NLMK and Maksimov had features of a shareholders agreement and, as a consequence, determined the management procedure in the company (which makes the dispute resulting from this agreement a non-arbitrable corporate dispute), or deemed as non-arbitrable the share sale and purchase agreement, considering it to be a corporate dispute. In any case, the decision of the ICAC, even after being reversed in the venue (Russia), was enforced in France[7] . At the same time, a demand for enforcement of the same decision in the Netherlands was not supported by the trial court, but the appellate instance, where Maksimov's party filed a complaint, did not rush to judgment and decided to study further the circumstances of the case and the applicable legal regulation[8]. The appeal is still being considered.

66. However, the Constitutional Court, in response to a complaint of the party to the case who won at the ICAC, indicated that the provisions of article 33 and 225.1 were directed *"at the specification of the order of relief for violated or disputed rights and the lawful interests of citizens and legal persons in the said category of cases."*

67. In practice, the Supreme Commercial Court and the lower courts had cases in which corporate disputes were deemed arbitrable subject to article 33 APC (see Ruling No 1557/07 of 16.02.2007), but it should be noted that in this case it was about the arbitrability of the dispute based on the contract of purchase and sale of a stake in the share capital.

68. It is believed that the arbitrability of corporate disputes involving limited liability companies is also limited by the wording of article 21 of the Federal Law "On Limited Liability Companies". In particular, paragraph 3, clause 11 article 21 provides that the purchaser of a stake in a company may require the transfer of the stake in court, with *"the decision of the commercial court on the transfer of the stake in the authorized capital of the company or a part thereof provides grounds for State registration of appropriate changes made to the Unified State Register of Legal Entities."* Paragraph 3 of Section 12 of the same article provides that in the event of notarization of the transaction of purchase and sale of a stake, transfer of the stake can be challenged *"only in court by filing a claim to a commercial court."* However, one should consider these wordings as resulting from defects in the formulation of legal technique of the Federal Law "On Limited Liability Companies", which are to be corrected in a routine manner in the course of introducing amendments to the law.

69. Until recently, the arbitrability of corporate disputes in limited liability companies could be questioned in connection with the provisions of the Federal Law "On state registration of legal entities and individual entrepreneurs." According to this law, information about the participants of a limited liability company, encumbrance of stakes, the person controlling the stakes, etc. should be disclosed in the Unified State Register of Legal Entities (YeGRIuL). Consequently, all debates leading to a change in this information could be described as public disputes. However, in the light of the decision of the Constitutional Court No 10-P, this conclusion seems erroneous. Writing about the arbitrability of disputes on real estate, the Constitutional Court stated that the "*State registration of rights to real estate and transactions with it ... is not a factor that changes the very nature of civil legal relations; "the duty of State registration of real estate rights and transactions cannot be regarded as a circumstance precluding the possibility of transferring disputes over property to the arbitration tribunals.*" This approach is also fully applicable to corporate disputes, leading to a change in the information in the Unified State Register of Legal Entities.

70. The difficulty in considering certain categories of corporate dispute in arbitration tribunals can be caused both by the need to respect the rights of third parties (as in most intra-corporate disputes), and the specifics of joining the arbitration clause for individual participants of corporate relations (government entities, members of the board of directors or shareholders) (Lisitsyn - Svetlanov, 2012). However, the possibility of these difficulties arising does not indicate the non-arbitrability of corporate disputes and will be covered in the following sections.

6.4. Conclusion of the arbitration agreement

71. The transfer of as many disputes to arbitration as possible can serve the ultimate goal of simplifying corporate conflict resolution. But for this to happen, the arbitration agreement should be able to provide the most comprehensive composition of those entities, whose disputes will be considered by the arbitral tribunal. If one recognizes the arbitrability of external corporate disputes (disputes resulting from contracts of purchase and sale of shares, shareholders' agreements, etc.), the inclusion of an arbitration clause in the text of the relevant contract would be a sufficient basis for the transfer of an appropriate dispute to an arbitral tribunal.

72. In this case, if a third party (not a party to the contract containing the arbitration clause) for some reason thinks that his right was violated by the decision made by the arbitral tribunal, they will be able to demand the reversal of such a decision (paragraph 11 of the Information Letter No 96 of the Presidium of Supreme Commercial Court, paragraph 6.1 of the Decision of the Constitutional Court No 10-P, etc.). Unfortunately, in practice this procedure gives the losing party the opportunity to use parties who were not involved in the arbitration, in order to challenge the decision of the arbitral tribunal, that is, *de facto* circumventing the agreement between the parties concerning the finality of the arbitral award or shortened periods for appealing the arbitral award (Asoskov A.V., 2011).

73. An ambiguous situation is also associated with the conclusion of the arbitration agreement on intra-corporate disputes (challenging the decisions of management of the legal entity, prosecuting members of the management bodies, forcing the holding of a meeting, exclusion of participants, etc.). Since the company statute is the only document which enshrines the civil legal status of the legal entity and governs the company's corporate affairs, it is reasonable to assume that the arbitration clause should be contained therein. Being placed in the statute, the arbitration clause becomes (along with the other provisions of the Articles) obligatory for both the legal entity and its bodies and shareholders.

74. However, there is a risk that the courts can see in this model the features of contract of adhesion, while paragraph 3 of article 5 of the Federal Law "On Arbitration Courts in the Russian Federation" does not recognize such an agreement if the arbitration agreement was concluded before the dispute: *"The arbitration agreement to resolve the dispute under the contract, the terms of which*

are defined by one of the parties in templates or other standard forms and could be accepted by the other party only by way of accession to the proposed contract as a whole (contract of adhesion), is valid if such agreement is concluded after the cause of action, and unless otherwise provided by federal law. "

75. In addition, please note that conclusion of the arbitration agreement is impossible without the relevant declaration of will of the joining entity. The inclusion of the arbitration clause in the statute of a newly created company should not be a problem, but existing companies will be forced to make changes to their current Articles. Here, there is an acute problem regarding the number of votes which must approve the decision on adopting the arbitral agreement. The most obvious answer is "unanimously", because only then will all of the company members be covered by the arbitration clause. However, from a practical point of view, it is most likely that not a single large public company would be able to compel its shareholders to vote for the arbitration clause (e.g. small private investors traditionally abstain from voting at general meetings due to the insignificance of their stake).

76. Provided that the clause is included to the statute by less than 100% of the votes of all company shareholders, then some shareholders will not be bound by it. This implies a need to find out whether the shareholder contesting their case in the arbitration court is a party to an arbitration agreement. In this context, it is impossible to imagine a situation in which, in order to establish whether a person is a party to an arbitration clause, it would be necessary to study the results of the vote of that person concerning the inclusion of the arbitration clause in the statute.

77. Also, existing case law does not recognize a shareholder to be a party to the arbitration agreement where this shareholder acquired shares in a company after the general meeting decided to include an arbitration clause in the Articles (Decree of the Presidium of the Supreme Commercial Court of 31 May 2005 in case No 11717/02).

78. A solution could mean extending the arbitration clause over the largest shareholders of the company, for example by including in the company's charter a requirement that prohibits large shareholders from exercising certain rights over the shares prior to their accession to the arbitration agreement. And the duty of the company to bring its charter in compliance with this requirement may be encompassed in the listing rules of trading platforms where Russian issuers' securities are traded. Unfortunately, this option does not solve the problem of third parties challenging the arbitral awards and, more importantly, minority shareholders retain the right to apply to a State court for resolution of corporate disputes.

79. Compared with the problem of accession to the arbitration agreement for minority shareholders, the question of the extension of the arbitration clause to the members of the board of directors and the companies' management board seems more straightforward. Possibly, enshrining in the company charter the obligations of such employees to sign consent for the transfer of all disputes to arbitration. Moreover, signing such an agreement would be a condition of taking part in the election of the board of directors or entering into an employment contract for the members of the management bodies.

7. Conclusions and recommendations

80. As follows from the above, improving the quality of resolution of corporate disputes in Russia can be done at least in three ways: improving the quality and independence of the commercial courts, creating a separate specialized court for corporate disputes and promoting arbitration as a means of resolving corporate conflicts.

81. The independence and competence of commercial courts is the key to successful development of the judicial system as a whole. However, it is perhaps the most difficult task of the

three methods identified. Unfortunately, the depth of the problems existing in the system of commercial courts and the scale of the necessary changes require a long time and continued efforts by the State and society before the system can reach the levels of courts from more developed jurisdictions.

82. In parallel with the commercial courts, it is possible to create a specialized effective court that would resolve corporate disputes and create practice in this area. However, this would require additional costs from the State and major regulatory work. In addition, the creation of specialized courts often distracts from solving more important problems in the judicial system, such as corruption (Bouchez, Karpf, 2006). Thus, even a specialized court is not immune from inheriting the shortcomings of the country's judicial system, whether it be difficulty in ensuring the independence of judges or formality of procedures.

83. Currently, the consideration of corporate disputes in Russia is almost entirely monopolized by the State courts. Arbitral awards for corporate matters would be subject to reversal in almost every case and could not be enforced in Russia. Creating a favourable environment for the resolution of corporate disputes in arbitration tribunals would fundamentally change the existing order. Here, it is not about creating a separate arbitration institution but about developing a pro-arbitration approach by the State courts and other law enforcement agencies.

84. In our view, it is possible to strengthen the role of arbitration tribunals by two approaches. The first, more radical, approach provides for enshrining in law the arbitrability of intra- and extra-corporate disputes. Perhaps this can be done through the adoption of a separate law on the review of corporate disputes in arbitration. The second approach is more evolutionary, and involves changing the status quo by creating a pro-arbitration stance on the part of the Constitutional Court and the Supreme Commercial Court. First of all, the arbitrability of corporate disputes must be confirmed; moreover, the arbitral tribunal, as a means of resolving intra-corporate conflicts, can be more actively marketed by financial platforms (for example, by imposing an obligation to include appropriate clauses in the charters of listed companies).

85. Both concepts of developing arbitration courts would be unthinkable without the support of the State courts, which control the enforcement of arbitral awards. Such support should be expressed, first of all, in a pro-arbitration attitude to arbitration clauses, in a low rate of cancellation of arbitral awards, and in the avoidance of situations where the award would be contrary to the earlier decisions of an arbitration tribunal in similar cases.

86. Since parties to the arbitration agreement have the right to choose the arbitral tribunal as they wish, then they should not be limited in their ability to choose any of the existing arbitral tribunals as an arbitration institute or provide for an *ad hoc* formation of the arbitral tribunal. But if the "imposition" of the arbitration under corporate disputes is done by a key financial institution (for example, by an exchange via strengthening the listing rules), it is reasonable to assume that a separate court of arbitration could be established for this purpose, and the rules of procedure therein would aim to facilitate consideration of corporate disputes specifically. Popularizing this court of arbitration as a forum for the resolution of corporate disputes would allow, *inter alia*, the development of a common format of the arbitration clause, which is important if disputes are to be avoided on the validity of such a clause as to its form and interpretation.

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NOTES

[1]Here and below, the term "corporate dispute" and "dispute in the area of corporate governance" are used as synonyms.

[2]Federal Law "On Amendments to Certain Legislative Acts of the Russian Federation of July 19, 2009 No 205-FZ.

[3]Official statistics for commercial courts in 2012 (http://stat.pravo.ru/)

[4]Hereinafter, the term "arbitration" will be understood as a court of arbitration and international commercial arbitration.

[5]Smith v. Van Grokom (488 A.2d 858 (Del. 1985)); Caremark (658 A.2d 959 (Del. Ch. 1996).

[6]See The Interim Report of the Alternative Dispute Resolution (ADR) work-stream of TheCity UK's UK- Russia Liaison Group on Moscow as an International Financial Centre" as of 23 March 2012http://www.thecityuk.com/uk-financial-services-overseas/overseas-articles/moscow-as-an-international-financial-centre-interim-report-of-adr-work-stream/

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