

The Optional Arbitration Agreement: A Russian Perspective



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International Touch

In order to understand the Russian approach to the optional arbitration agreement, a short tour of international jurisprudence is necessary, given that Russian legal doctrine and practice now borrows many concepts and ideas from the experience of the international legal community.

Clarity is the key word when drafting an arbitration agreement. Where there is lack of clarity an arbitration clause is frequently referred to as a “pathological clause” – a term introduced in 1974 by Frédéric Eisemann, Secretary-General of the ICC International Court of Arbitration for 26 years.¹ In Craig, Park & Paulsson’s commentary on ICC Arbitration,² in relation to the analysis of pathological elements of an arbitration agreement, the authors note “[i]f the arbitration clause does not exclude recourse to the jurisdiction of the ordinary courts, one simply cannot rely on the arbitration agreement. [...] Parties may thus lose their ability to arbitrate by treating the mechanism as an option.”³ Fouchard, Gaillard and Goldman in *On International Commercial Arbitration* state that

an arbitration agreement may be pathological for a number of defects or reasons, including if “the agreement may appear to allow submission of disputes to arbitration to be optional”⁴ From a US perspective, Gary Born writes that “[p]arties sometimes agree only to consider arbitration as an alternative or optional means of dispute resolution, but not to require mandatory submission of future disputes to arbitration. Such agreements are almost always ill-advised, because they serve virtually no meaningful purpose and give rise to procedural confusion.”⁵ In other words, the citations above suggest that an agreement seeking to combine the submission of disputes to arbitration and the designation of a state court appears to be pathological, and therefore possibly runs the risk of being held invalid.

That being said, it is true that giving one or more of the parties to the arbitration agreement an option to choose between arbitration and the courts is widespread practice, particularly in finance-related contracts. The viability of such a mechanism may find support in the principle of effective interpretation that suggests that

preference should be given to the interpretation that gives meaning to the words rather than that which makes them meaningless.⁶ It appears that national courts of some countries (e.g. France, the United Kingdom, the United States) seek to uphold the validity of such clauses. As one French court put it: *“an ambiguous arbitration clause should be interpreted by considering that if the parties had not wished to submit their dispute to arbitration, they would simply have refrained from mentioning the possibility of doing so.”*⁷ Behind this thinking is the original intent of the parties to have their potential dispute resolved by arbitration, even if in combination with another type of dispute resolution mechanism.

Although there currently appears to be a tendency to favour optional arbitration clauses; given the variety of possible scenarios they may give rise to, the optional arbitration agreement could well be subject to a successful attack. If the option is reserved for one party only, the viability of the clause could be undermined due to lack of equality. For example, in 1991 a German court (albeit within a domestic context) invalidated an arbitration clause *“giving the party that drafted the disputed conditions the choice between the courts and arbitration.”*⁸ On the other hand, *“when the option is given to both parties, the clause is unquestionably pathological since one party may opt for arbitration and the other for the courts thus creating inextricable conflicts.”*⁹ It therefore seems that an optional arbitration agreement, depending on the degree of uncertainty or compatibility with other legal principles of the enforcing country, might still be described as pathological.

The Russian Legal Framework – General Overview

There are two bodies of law in Russia that are relevant to the validity of an arbitration agreement: international law and domestic legislation. While legal theory assists in the interpretation of legal rules, Russian case law is also extremely important, and sometimes even attempts to overrule legislation.

The main international treaty pertaining to arbitration agreements is the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the **“New York Convention”**). The USSR acceded to the New

York Convention in 1960, and also acceded to the European Convention on International Commercial Arbitration (the **“European Convention”**) in 1961. After the disintegration of the Soviet Union, the Russian Federation declared itself a successor to the USSR. According to Russian diplomatic declarations made thereafter, the Russian Federation would continue to honour its obligations and rights arising out of international treaties. This means that Russia is bound by all international treaties that the USSR was party to, including the New York Convention and the European Convention.

The primary domestic legislation governing international arbitration is the 1993 Law On International Commercial Arbitration (the **“Russian Arbitration Law”**). The Russian Arbitration Law is based on the UNCITRAL Model Law – in fact, it is nearly an absolute copy. It should be noted that under the Russian Constitution international law takes precedence over domestic legislation. Therefore, in the event of a conflict between the Russian Arbitration Law or any other piece of national legislation, on the one hand, and the New York Convention and the European Convention, as well as any other international treaty, on the other, international law will always prevail.

It should also be noted that Russian case law has been dramatically affected by procedural changes over the last few years. The Russian Federation has two types of courts: (i) courts of general jurisdiction (the **“general courts”**), and (ii) specialised commercial courts known as *arbitrazh* courts. In the past there was rivalry between the general courts and the *arbitrazh* courts over jurisdiction to enforce arbitral awards and, thus, to create case law relevant to enforcement in general and the interpretation of an arbitration agreement in particular. Although originally only general courts dealt with enforcement, a decade ago *arbitrazh* courts also started claiming jurisdiction.

In 2002, the issue was resolved by legislation in favour of the *arbitrazh* courts, resulting in the alteration of case law. Overall, the courts of general jurisdiction had adopted quite a favourable view towards arbitration. At the beginning of their period of powers of enforcement, the *arbitrazh* courts showed greater reluctance in supporting international commercial arbitration. In this regard it is worth

referring to the case law of the International Commercial Arbitration Court at the Chamber of Commerce and Industry of the Russian Federation (the “ICAC”). Although the ICAC is not a state court, the reasoning of its awards may be indicative of the status of thinking in the legal community who are naturally pro-arbitration oriented – perhaps with the potential to lobby for their points of view before the legislature and the judiciary. Other than that, of course, ICAC case law is not binding on the arbitrazh courts. Moreover, an ICAC’s award may be annulled by the arbitrazh courts. In this sense the effect of ICAC practice is closer to the legal theory rather than case law.

Legal theory on international commercial arbitration is not yet very developed in Russia, but is progressing rapidly – especially in light of economic globalisation and jurisprudence. Apart from law professors, in practice, most influential scholars are those associated with the judiciary, for example, judicial personnel (advisors and researchers in higher courts’ research departments, e.g. at the Private International Law Department at the Supreme Arbitrazh Court of the Russian Federation, etc.) or judges themselves. Appearing in law journals and other media, their publications and presentations can be as authoritative as case law.

Viability And Practicability Of The Optional Agreement In Russia

The following quote from Professor Yarkov’s (a member of the Research and Advisory Board at the Supreme Arbitrazh Court of the Russian Federation) textbook on Russian law refers to the pathological arbitration clause (type (2)):

*“Depending on their contents, the arbitration clauses of two types may be distinguished: (1) a clause whereby one or more of the parties may choose between several arbitration courts; and (2) a clause giving a choice between a state court and the arbitration court specified therein. The first type is wide-spread, and it is considered to be an arbitration agreement both by the arbitration practice and the courts of different states. The second type is not considered by Russian doctrine and case law to be an arbitration agreement reached by the parties. It appears that the approach adopted by our state courts is in line with the prevailing case law of courts of other countries.”*¹⁰

The first type (i.e. where there is a choice between various arbitration courts) is widely recognized by the ICAC. However, Russian courts are sometimes reluctant to uphold even this type of clause – perhaps due to additional uncertainties. For example, in one case a Russian court ruled that the parties had failed to agree upon a particular arbitration court because *“the parties actually provided for an optional jurisdiction, without specifying exactly what arbitration institution will have jurisdiction,”* and proceeded to hear the case on the merits. It should be noted however that the arbitration clause was not very clear: *“a dispute [...] shall be submitted to arbitration to be resolved by the Arbitration court at the Chamber of Commerce and Industry of the Russian Federation in Moscow in accordance with its Rules or by the Chinese Committee of Assistance for Foreign Trade In Beijing. Should one of the parties disagree with the award of these bodies, this party shall have the right to apply to the international arbitration body.”*¹¹ In another case, the same court was asked to enforce the ICAC’s award where the ICAC asserted jurisdiction under the following clause: *“[D]isputes shall be submitted to the arbitration of the Client’s Chamber of Commerce and Industry if the party at fault is the Client, or to the Contractor’s Chamber of Commerce and Industry if the party at fault is the Contractor.”* The court came to the conclusion that the parties had failed to reach an arbitration agreement.¹²

The second type (providing for an option between arbitration and a state court) is much more problematic. It is not entirely clear what legislative basis is relied upon in the textbook, however a reference is made to Karabelnikov’s commentary on the New York Convention, the first Russian treatise on the treaty,¹³ where the author seems to suggest that the optional nature is incompatible with Article II of the New York Convention. According to Article II.1 *“[e]ach Contracting State shall recognize an agreement in writing under which the parties undertake to submit to arbitration all or any differences [...]”* (emphasis added). Under Article II.3, *“[t]he court of the Contracting State, when seized of an action in a matter in respect of which the parties have made an agreement within the meaning of this article shall, at the request of one of the parties, refer the parties to arbitration, unless it finds that the said agreement is null and void, inoperative or incapable of being*

performed” (emphasis added). It should be noted that identical words are contained in the UNCITRAL Model Law and the Russian Arbitration Law. Karabelnikov specifically refers to financial deals involving a Russian borrower or issuer, on the one hand, and UK-based banks or international financial institutions, on the other, where the latter reserves the option to sue in England or elsewhere. Sometimes this option is accompanied by a refusal of the Russian borrower or issuer to raise jurisdictional defences in the event of either the commencement of arbitration or litigation.

This mechanism is criticised for lack of equality, apparently being incompatible with the approach adopted in the New York Convention referring to *parties* (rather than one party).¹⁴ (In this regard it is appropriate to note that Fouchard, Gaillard, Goldman in *On International Commercial Arbitration* state that “when the option is given to both parties, the clause is unquestionably pathological”).¹⁵ It also seems that when the option is reciprocal, the court, when seized with an action, with reference to Article II.3 of the New York Convention (a similar provision is contained in Article VI of the European Convention), may (or should) submit the parties to arbitration, if a party so requests; thus rendering the original option meaningless. In one case the ICAC, reviewing a clause providing an option to choose between arbitration and a state court, ruled that filing a suit with a state court “transforms the arbitration agreement into the agreement incapable of being performed.”¹⁶ V. Khvalei, in his article “How To Kill An Arbitration Agreement” alerts us to the risk that an optional agreement, with an option to choose between arbitration and a state court, may be held as finally not agreed.¹⁷

It appears that the foregoing conclusion is based on the interpretation of international treaties rather than pure domestic legislation. Therefore, for example providing for English law as the governing law of the arbitration agreement (assuming an optional arbitration agreement is valid under this law) would be unlikely to be helpful, as the New York Convention will always prevail over domestic (Russian or English) law.

As mentioned above, Prof. Yarkov’s textbook indicates that Russian case law does not recognise the second type of arbitration agreement as the agreement to arbitrate. We are not aware of any reported case law dealing

explicitly with this type of clause, although perhaps unreported decisions do exist. It seems however that irrespective of whether or not this case law exists the current status of thinking should alert parties to the risk of the optional arbitration clause being held either as incapable of being performed, or having not reached agreement, or causing other adverse effects.

As a practical matter, the ‘optionality’ may comfortably be used in a situation when a potential debtor has assets, substantial and readily available, in a country where a (English) court judgment is easily enforceable. To avoid the risk, parties should agree upon an arbitration-only scheme. If however the subject matter of the dispute is not capable of being resolved by arbitration (e.g. the subject matter falls within the exclusive jurisdiction of Russian courts), a national court of law ought to be chosen – of course if this choice is permitted.

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Alexey is counsel and co-head of our disputes practice. He has significant experience in international and domestic arbitration and litigation. He was recognized as a leading expert by the International Who’s Who of Product Liability Defense Lawyers in Russia. He is an arbitrator at The International Court of Arbitration under the Chamber of Commerce and Industry of the Kyrgyz Republic. He is a frequent participant and speaker at international legal conferences. Alexey has also authored and contributed to various local and international publications. Prior to joining White & Case in 2007 he worked as counsel in a major UK law firm in Moscow. Qualified to practice law in the Russian Federation and speaks Russian, English, Spanish, French.

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- 1 Frédéric Eisemann, *La clause d’arbitrage pathologique*, COMMERCIAL ARBITRATION – Essays in memoriam Eugenio Minoli 129 (1974).
 - 2 W. Laurence Craig, William W. Park, Jan Paulsson, *International Chamber of Commerce Arbitration*, (3rd. ed., Oceana, 2000).
 - 3 *Ibid.*, p. 128.
 - 4 Fouchard, Gaillard, Goldman, *On International Commercial Arbitration* (E. Gaillard & J. Savage (eds), Kluwer Law, 1999), para. 484.

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- 5 Gary B. Born, *International Commercial Arbitration, Commentary and Materials*, 327 (2nd. ed, Transnational Publishers & Kluwer Law International, 2001).
- 6 Fouchard, Gaillard, *Goldman, On International Commercial Arbitration* (E. Gaillard & J. Savage (eds), Kluwer Law, 1999), para. 478.
- 7 *Ibid.*, para. 490.
- 8 *Ibid.*, para. 488.
- 9 *Ibid.*, para. 488, note 133.
- 10 V. Yarkov, *Arbitrazh Court Procedure: A Textbook For Law Students*, 664 (2nd. ed., WoltersKluwer, 2005)
- 11 Federal Arbitrazh Court of the Eastern-Siberian Okrug, Case № A78-1400/02-C1-11/57-Φ02-2307/02-C2, dated August 15, 2002.
- 12 Federal Arbitrazh Court of the Eastern-Siberian Okrug, Case № 86/01-C1/02-Φ02-3818/02-C2, dated January 8, 2003.
- 13 B. Karabelnikov, *Enforcement of International Commercial Arbitration Awards, Commentary on the 1958 New York Convention and Chapters 30 and 31 of the 2002 Arbitrazh Procedural Code of the Russian Federation* (2nd. ed., FBK-Press, 2003).
- 14 *Ibid.*, p. 98.
- 15 Fouchard, Gaillard, *Goldman, On International Commercial Arbitration* (E. Gaillard & J. Savage (eds), Kluwer Law, 1999), para. 488, note 133.
- 16 M. Rozenberg, *The Validity of Alternative Arbitration Agreement*, *Yurist* № 24 (2002) p. 6.
- 17 V. Khvalei, *How To Kill An Arbitration Agreement*, *Treteisky Sud* № 5 (2003) p. 54.