

This article first appeared in a slightly different form in *Euromoney Emerging Markets Handbook 2008/09*

Optional disputes clauses for Russian deals—spoilt for choice?

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“Where are the defendant’s assets?” In the context of international disputes, this is perhaps the single most important question that a claimant needs to address before pursuing a “litigation” strategy. In the great majority of cases, there will be scant benefit in obtaining an order from a national court which cannot be enforced in the country where the defendant has its assets. Whilst, for example, a judgment from the English Court will be readily enforceable in a great many countries, including throughout Europe and the Commonwealth, there are notable exceptions. For example, there has only been one reported case of the Russian Federation enforcing a judgment from a UK court. That was a judgment in favour of creditors of the former oil major, Yukos and is considered by most commentators to have been politically motivated and anomalous.

In the context of disputes arising out of emerging markets deals, the problem of where to sue is all the more acute. The experience and independence of the judiciary in certain emerging economies is still a work in progress and the prospect of bringing a substantial claim against an entity based in such a state, particularly an entity with political affiliations, is unappealing. One solution increasingly adopted in international transactions is arbitration. Pursuant to the 1958 Convention on the Recognition and Enforcement of Foreign

Arbitral Awards (commonly referred to as the “New York Convention”) international arbitral awards are, subject to limited defences, enforceable through local courts in signatory states via what is (at least in theory) a straightforward procedure. There are currently 142 state signatories to the New York Convention, including Russia, most of the other CIS states and a large number of other emerging markets where an international arbitral award is, as a result, often more valuable than a foreign national judgment.

Notwithstanding the advantages of arbitration when suing, for example, a Russian defendant, parties who are likely to come to a dispute with a strong case—for example a lender claiming against a defaulting debtor—may be reluctant to tie themselves to arbitration. This is because international arbitration, for all its virtues, does not usually offer the decisive summary procedures available to a claimant or defendant in the English (and other national) courts and the scope for a party with a weak case to protract proceedings is far greater. Parties with a superiority of bargaining power (most frequently lenders or other “finance parties”) therefore prefer to keep their options open so that, having analysed the particular circumstances of the dispute, they can elect whether to arbitrate or to litigate and, if the latter, where they will do so.



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The result has been the development of increasingly sophisticated, one-sided dispute resolution clauses in international commercial contracts. The intention of such clauses is to afford the party with superiority of bargaining power (eg. the lender) maximum flexibility as to how or where to bring a claim against the counter-party (eg. the borrower) whilst ensuring that the lender retains a contractual right to be sued in a forum where it feels comfortable. The market-standard clause which first developed in English-law finance documents provided that:

1. The borrower agreed that all disputes would be subject to the exclusive jurisdiction of the English courts;
2. The lender had the right to sue in other courts; and
3. The lender had the option (at its sole discretion) to arbitrate any claim made by or against it.

Points 1 and 2 of such clauses are largely uncontroversial. Within Europe, it followed from the 1968 Brussels Convention on Jurisdiction and Enforcement of Judgments in Civil and Commercial Matters¹ that parties could conclude a jurisdiction agreement that is exclusive from one party's perspective (i.e. that party may only bring proceedings in the chosen forum) but non-exclusive from the other party's perspective (i.e. that party may rely on the clause to bring proceedings in the chosen forum but has freedom to bring proceedings elsewhere).²

On the other hand, point 3 (the one-sided option to arbitrate), has become an object of scrutiny and a subject of debate. In particular, the validity of a one-sided "optional" agreement to arbitrate and the enforceability of an award made pursuant to such an agreement, have been questioned in Russia amongst other countries. Although there is no reported judicial authority, academic questions have been raised in Russia over whether optional agreements to arbitrate, particularly one-sided ones, are consistent with concepts of procedural equality enshrined in national law and promoted both by the New York Convention and the UNCITRAL Model law on International Commercial Arbitration.

As a matter of English law, it is established beyond doubt that optional and, indeed, one-sided agreements to arbitrate are valid and binding.³ In such cases, the election by one party to arbitrate has been characterised as crystallising an existing agreement to submit disputes to arbitration. A party seeking to enforce an award made pursuant to an optional arbitration agreement governed by English law can draw some comfort from this. One of the few defences to enforcement under the New York Convention is that the agreement to arbitrate was "*not valid under the law to which the parties have subjected it*".⁴ Insofar as optional clauses governed by English law are concerned, therefore, this defence should not apply.

However, some Russian academic articles⁵ have suggested that an agreement which does not allow one party to file arbitral proceedings of its own motion does not meet the criteria for an arbitration agreement under Article II.1 of the New York Convention because it is not an agreement "*under which the parties undertake to submit to arbitration*" (emphasis added).⁶ The hypothesis is that such inequality would provide a defence to recognition or enforcement of an international arbitral award in Russia. Courts in other countries which have not tested the issue may yet take a similar view and the risk will be greatest in places with limited exposure to international commerce where the courts' disposition remains protectionist. Moreover, even if the argument under Article II.1 of the New York Convention were rejected, the ubiquitous "public policy" defence might alternatively be invoked. For example, the broad principle of "equality of parties" enshrined within the Ukrainian Commercial, Civil and Procedural Codes has hitherto been given wide and flexible interpretation by the Ukrainian courts and could well be invoked as a matter of policy to resist enforcement of an international arbitral award made under a one-sided agreement.

The London market has been alive to these risks for some time but financing parties have remained reluctant to surrender the benefits of flexibility. As a result, a revised version of the standard optional one-sided disputes clause has developed over the last

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two years, which seeks to minimise the risks. Simply put, the revised clause provides that:

1. All parties agree to arbitrate disputes; but
2. A lender can elect at its sole discretion to withdraw consent to arbitration⁷ such that (i) any proceedings must be brought against it in the English court; and (ii) it can bring proceedings in the English court or elsewhere.

The rationale for the revised clause is that, unlike the previous structure, it contains an agreement by both parties to arbitrate, albeit subject to one party's right to opt out, and therefore addresses the potential concern under Article II.1 of the New York Convention. Of course, the argument that an agreement to arbitrate which is subject to a one-sided opt-out is less objectionable than an agreement to litigate which is subject to a one-sided opt-in, might be said to look like an argument for form over substance, and such clauses still entail a degree of risk.

In every case where pursuit of assets overseas is a real possibility, a party should check the position on enforceability of foreign judgments or international arbitral awards in the jurisdiction in question. The answer to these questions will inform the way in which the relevant disputes clause should be drafted. For example, if the jurisdiction in question will readily enforce English judgments, there may be no need to take the risk of drafting in an option to arbitrate. The problem area, however, is the overlap between states which do not generally enforce English judgments and those which are most likely to entertain creative defences to enforcement under the New York Convention. In these cases, the presence of an underlying arbitration agreement that does not confer mutual rights may heighten the risks to enforceability and the necessity of structuring a clause in this way should always be carefully considered. In certain circumstances, the best way to minimise the risk posed by optionality may be to exclude it altogether and adopt a straightforward arbitration agreement. Such an approach would, of course, come at the expense of flexibility.

The difficulty in assessing the level of risk is that the validity of one-sided optional disputes clauses has not yet been tested in the Russian courts or in the great majority of emerging markets and, until

authority exists, parties can do no more than balance the potential risks in a pragmatic way on a country-by-country basis. If flexibility is paramount then parties would be well-advised to minimise the risks by adopting the second of the two arbitration clauses considered above (i.e. with a litigation opt-out).

It is hoped that when these clauses are put to the test at the enforcement stage, the arguments already accepted by English and US courts will ultimately prevail and that optionality, one-sided or otherwise, will not be viewed as tainting an arbitration clause that has been *agreed* between the parties. After all, a great many states, including Russia, are party to investment treaties where the states in question have agreed that disputes falling within the scope of the treaty may be arbitrated at the option of the investor.

For the time being, the London finance market appears to have concluded that the flexibility afforded by one-sided optional disputes clauses in Russian deals outweighs the possible risks such clauses may entail.

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1. Since superseded by Council Regulation (EC) 44/2001 ("The Brussels Regulation").
2. See Article 17(4) of the Brussels Convention.
3. *Three Shipping Ltd v Harebell Shipping Ltd* [2004] EWHC 2001 (Comm). The same view has been taken by courts in the US.
4. In full, Article V.1(a) of the New York Convention provides that recognition or enforcement of an arbitral award may be refused if "The parties to the agreement referred to in article II were, under the law applicable to them, under some incapacity, or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made."
5. See, for example, "Enforcement Of International Commercial Arbitration Awards. Comments To The 1958 New York Convention And Chapters 30 And 31 Of The Commercial Court Procedural Code Of The Russian Federation Of 2002" (second edition, reviewed and supplemented) (B. R. Karabelnikov) (ID FBK-PRESS, 2003)
6. In full, Article II.1 of the New York Convention states that "Each Contracting State shall recognize an agreement in writing under which the parties undertake to submit to arbitration all or any differences which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not, concerning a subject matter capable of settlement by arbitration."
7. The clause is drafted so that the finance parties' option is exercisable at any time prior to nominating an arbitrator.