

Client Alert

International Arbitration Practice Group

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Russia's Supreme Arbitrazh Court Summarizes Application of the Public Policy Clause

As in many other countries in the world, in Russia the violation, by a foreign state court judgment or arbitral award, of the public policy constitutes a ground to deny recognition and enforcement of such judgments and awards. Therefore, it is key to carefully draft the dispute resolution clause in contracts and to make use of foreign courts or arbitral tribunals, if the judgments or award is going to be enforced in Russia. In April 2013, the Supreme Arbitrazh Court of the Russian Federation (SAC), Russia's ultimate body for resolution of commercial disputes, published its Review of practice of arbitrazh courts on application of public policy clause in court cases as a ground for denial of recognition and enforcement of foreign judgments and arbitral awards (the "Review").

Background

Historically, the public policy clause in Russia has been characterized as lacking precise definition as well as meaningful guidance on terms of its application. Due to this, Russian courts construed this clause very broadly. Quite frequently, this led to rendering of unfair judgments: the public policy clause had the reputation of being abused as an instrument to resist recognition and enforcement of foreign judgments and arbitral awards.

By publishing the Review the SAC attempted to harmonize application of the public policy clause and to provide certain basic and case-specific guidance of its applications. While not being exactly mandatory, the reviews of the SAC, including the Review at hand, are still heavily relied upon by lower Russian arbitrazh courts which tend to adhere to the review's provisions when considering the cases.

New definition of public policy

Prior to the publication of the Review, the most elaborated definition of the public policy was provided in the 2005 SAC review of practice of arbitrazh courts on recognition and enforcement of foreign judgments, contesting arbitral awards and issuance of writs of execution on enforcement of arbitral awards. According to the said review the public policy was defined as *basic principles of the Russian law including equality of parties in civil law relations, good faith of parties and proportionality of civil law liability to the consequences of a culpable breach of law.*

The Review specifically addressed the issue of ambiguity and lack of clearance of the aforementioned definition. In particular, it narrowed the definition of public policy which now shall mean *fundamental legal principles of the highest precedence and universality, which have particular importance for the society and the public and form the basis of*

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the economic, political and legal systems of the state. Such principles include, without limitation, prohibition of actions which:

- (i.) are expressly prohibited by super-imperative provisions of the laws of the Russian Federation (Article 1192 of the Civil Code of the Russian Federation); and*
- (ii.) violate the sovereignty or security of the state, affect the interests of large social groups and violate constitutional rights and freedoms of private persons.*

New take on general principles application of public policy

In addition to providing a more precise definition of the public policy, the Review established some principles of application of the public policy clause by Russian courts. In particular, the Review sets forth that:

- *application of the public policy clause requires exceptional circumstances;*
Public policy clause should not be chosen by Russian courts as the ground to refuse recognition and enforcement of foreign judgments and arbitral awards instead of special grounds for such refusal provided for by the international treaties of the Russian Federation and provisions of the Russian Arbitrazh Procedural Code.
- *application of public policy clause shall not lead to revision of the case on its merits;*
When considering the effects of a foreign judgment and/or arbitral award in terms of their compliance with the public policy, the courts will not review the merits.
- *a claim of violation of public policy shall be valid;*
A party claiming that recognition and enforcement of a foreign judgment or arbitral award is contrary to the public policy bears the burden of proof of such contradiction;
- *absence of similar or analogous provision in the Russian law does not constitute violation of public policy;*
Foreign judgment or arbitral award may not be considered as violation of Russian public policy only on the grounds of an absence of provisions in the Russian law that are similar or analogous to the rules of the applicable foreign law.

Case-specific application of public policy clause

In addition to the above, the Review features the following case-specific examples of application of the public policy clause, which may be of interest:

- *Corruption is a public policy breach;*
Enforcement of a foreign arbitral award made on the basis of agreement entered into as the result of a commercial bribery contradicts public policy and, therefore, shall not be allowed.
- *Breach of principle of independence and impartiality of arbitrators violates public policy;*
Recognition and enforcement of an arbitral award that was rendered in breach of the principle that arbitrators should be independent and impartial (e.g. by an arbitrator who also served as an officer of a parent company of one of the parties), may be considered as violation of public policy and thus refused.
- *Liquidated damages may contradict public policy;*
In the past, Russian debtors against whom a foreign judgment or arbitral award had to be recognized and enforced argued that the damages awarded to the creditor are extremely high and, therefore, such foreign judgment or arbitral award contradicts Russian public policy and shall not be recognized. Under Russian

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law, the damages cannot be a source of enrichment: the damages shall only compensate the harm caused, such harm being actual losses and lost profit (subject to thorough proof).

According to the Review, recognition and enforcement of foreign judgments involving liquidated damages may be viewed as contradicting public policy if:

- (i.) the *amount* of liquidated damages is abnormally high and exceeds the amount of damages that the parties could have reasonably foreseen when entering into a contract; and
- (ii.) there were obvious signs of abuse of freedom of contract when negotiating such damages (in the form of exploitation of the debtor's poor negotiation skills, breach of public interests and interests of third parties etc.);

Thus, although the court should not review the merits of an award, the above recommendations on liquidated damages may contradict this general rule because to establish that the amount of liquidated damages is unreasonably high and/or there had been signs of abuse of freedom of contract, Russian judge needs to look into the merits.

- *Requirement to pay a court deposit does not contradict public policy;*
Requirement of foreign court to pay a deposit as a condition to appeal a foreign judgment or arbitral award as a general rule will not be considered as violation of public policy and a ground to refuse recognition and enforcement of such judgment and/or arbitral award.
- *Non-compliance by a foreign entity with the applicable major transactions approval procedure does not contradict public policy;*
Non-compliance by a foreign entity with its internal corporate governance procedure for approval of major transactions cannot be qualified as breach of Russian public policy and does not constitute a ground for refusal to recognize and enforce foreign judgment or arbitral award based on non-performance of the said transaction by a party to it.
- *Enforcement against property jointly owned by spouses without the participation of the debtor's spouse in court (or arbitration) proceedings does not contradict public policy;*
According to Russian law, execution may be levied on the property of a married person who is the debtor, and—if such property is insufficient—on that person's share in property jointly owned by both spouses. The fact that property is jointly owned by the spouse and the debtor's spouse did not participate in the court (arbitration) proceedings does not contradict Russian public policy and shall not serve as a ground for refusal of recognition or enforcement of foreign judgment of arbitral award.

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