Recovering money from a Russian Personal Guarantor:

Enforcement of foreign courts’ judgements and arbitral awards

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Introduction

When examining the credit risk associated with lending to Russian borrowers and/or taking as part of the collateral package (in a transaction that may not involve a Russian borrower or other security provider) a personal guarantee (“Guarantee”) from a Russian guarantor (“Russian Guarantor” or “Guarantor”), lenders need to consider the possibility of default, how best to protect their position and what issues should be taken into account when considering enforcing foreign (non-Russian) judgments and arbitral awards against the Guarantor in Russia. The difficulties of enforcing foreign judgments in Russia are well known and are a cause of great concern to both lenders and foreign investors seeking to do business in the Russian Federation or with Russian entities or individuals.

One of the key questions that arises when examining the credit risk associated with a potential transaction involving a Russian borrower or Russian Guarantor is the possibility of having to enforce security, or a Guarantee in the Russian Federation, which means that the lender would either need to seek a judgment from Russian courts directly, or obtain a judgment from a foreign court or an arbitral award from a foreign arbitration tribunal and seek to enforce it in the Russian courts.

The purpose of this briefing paper is to provide an overview of the current law relating to the enforcement of foreign courts’ judgments and arbitral awards in the Russian courts and to outline some practical solutions and considerations for lenders seeking to do business with Russian entities should lenders need to commence enforcement proceedings in Russia.

As this paper is aimed mainly at the private wealth divisions of banks, we have focussed on transactions involving a Russian Guarantor, rather than a Russian borrower. This is because, in our experience, the typical asset finance transaction involving a Russian customer will be structured so that there is an offshore SPV borrower and security provider (who will own the asset or class of assets which are to be secured in favour of the lender), potentially other grantors of security incorporated outside Russia and, often but by no means always, a Russian Guarantor (the beneficial owner).

Recognition of Foreign Arbitral Awards

Under the Arbitration Procedural Code of the Russian Federation (“APC”) Russian courts will recognise and enforce judgments of foreign courts if such recognition and enforcement is provided for by the International Agreement of the Russian Federation and Russian Federal law.

Russia (like the United Kingdom) is a signatory to the UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (“New York Convention”) which regulates the process of recognition and enforcement of arbitration awards, thus making it fairly straightforward. Pursuant to the New York Convention, Contracting States are obliged to recognise arbitral awards as binding and enforce them in accordance with their rules of procedure after the party seeking enforcement of a foreign arbitral award has supplied to the court the arbitral award and the arbitration agreement.

The New York Convention prohibits the imposition of substantially more onerous conditions or higher fees or charges on the recognition or enforcement of the foreign awards than those which are imposed on the recognition and enforcement of domestic arbitral awards.

Given the increased certainty in the approach of Russian courts to the enforcement of international arbitral awards, a frequently adopted solution for lenders and investors when dealing with Russian Guarantors is to require submission by the Guarantor to arbitration rather than court proceedings as a binding means of dispute resolution and to include an appropriate jurisdiction/arbitration clause into the Guarantee. By virtue of the arbitration clause the parties undertake to submit to arbitration all or any disputes which have arisen or which may have arisen between them in respect of the Guarantee.

It is important to emphasise that so-called "sole-option" or “forum-selection” dispute resolution clauses are no longer enforceable in Russia. When the sole-option clause requires all disputes to be referred to arbitration but gives a lender alone the right to bring certain claims in any court of competent jurisdiction, the Russian courts will either be able to assume the jurisdiction on application made by either party or the entire dispute
resolution clause may be invalidated. In the Russian Telephone Company v. Sony Ericsson Mobile Communications case the Presidium of the Supreme Commercial Court, Russia's highest commercial court, decided that under the sole-option clauses each party should be able to bring the court case because each party should have equal procedural rights and access to the courts.

**Process of enforcement of foreign arbitral awards in Russia**

The first step is to make an application for the recognition and enforcement of a foreign arbitral award in a Commercial Court of the relevant Federal Subject (being the Russian Federal State where the respondent resides or, if the place of his or her residence is unknown, at the Commercial Court of the Federal Subject of location of his or her assets). The application is then considered by the Commercial Court within three months from the date of its filing. The Commercial Court does not examine the merits of the case itself and will only consider whether there are any grounds for refusing recognition and enforcement of the arbitral award. The Commercial Court then makes a decision as to whether the award is recognisable and enforceable in Russia.

If the Commercial Court refuses to recognise and enforce an arbitration award (for example, on public policy grounds), either party can appeal such decision on enforcement and recognition of the arbitral award to a Court of Cassation (a Federal District arbitration court) of the relevant Federal Subject within one month from the day when the decision to refuse to recognise and enforce is made.

**Enforcement of foreign arbitral awards in Russia – some considerations**

There are certain considerations of which lenders have to be aware in order to minimise possible complications with the recognition and enforcement of foreign arbitral awards made against Russian Guarantors:

- One major issue when applying for the recognition and enforcement of foreign arbitral awards in Russia is the willingness of the Russian courts to apply the public policy rule and refuse to recognise and enforce a foreign arbitral award on public policy grounds. Due to the vague definition of “public policy” provided by the APC and Russian case law, it is almost impossible to predict exactly what the Russian courts will consider to be against public policy. It is therefore difficult for lenders to structure transactions and resolve disputes in a way that would not trigger a rejection for recognition and enforcement based on public policy. It is almost certain that the debtor will rely on the public policy defence and, therefore, it is vital for the lender to understand the application of this rule before taking the Guarantee.

Some examples of what the Russian courts have considered, in past cases, to be against public policy when considering applications for the recognition and enforcement of foreign arbitral awards are:

i. In the case of United World v Krasny Yakor the court refused recognition of a foreign arbitral award on public policy grounds as it held that the enforcement of the relevant foreign arbitral award would lead to the bankruptcy of Krasny Yakor (a state-owned entity), and as a result, it would have a negative effect on the social and economic stability of the city of Nizhny Novgorod and, consequently, on Russia as a whole, since Krasny Yakor manufactured products of strategic value for security and national safety of the country.

ii. In another case the court held that it could not allow the recognition and enforcement of a foreign arbitral award because it was unclear whether the respondent operated using the funds of its parent company (a state-owned entity) and, since such funds belonged to the Russian state, enforcement of the award would indirectly damage national property and would be against the public policy of Russia.

- In addition to refusing to recognise foreign arbitral award on the public policy grounds, Russian courts often refuse enforcement on the grounds that names of a relevant foreign arbitration tribunal and/or a Russian entity or individual are spelt one way in the Guarantee and another way in the arbitration award. It is, therefore, vital to check and ensure consistency in the use of the parties' names throughout the documents from the outset. It is also recommended that, when dealing with an individual Russian Guarantor, his/her name is spelt exactly as it appears in the Russian Guarantor's passport.

1 Moscow National Bank Ltd v. MNTK Microhiryrgiya Glaza
One further defence which Russian Guarantors often raise against recognition and enforcement by a Russian court of a foreign arbitral award made against them is that the award was granted in connection with a dispute which was not contemplated by or does not fall within the terms or scope of the submission to arbitration, or that the award contains decisions on matters beyond the scope of the submission to arbitration. Russian Commercial Courts confirmed in a number of decisions that in order to rely on this defence, the party raising the defence must show that he/she objected to the jurisdiction of the foreign arbitration tribunal in the country where the request for arbitration was made (and followed the procedure provided by the national laws of that country) at the time when the request for arbitration was made and not when the claimant (i.e. the lender) is already seeking enforcement of the foreign arbitral award in Russia.

It should also be noted that when making an application for recognition and enforcement, a notarised Russian translation of all the relevant documents, including the arbitration award itself and the Guarantee, must be submitted to the Russian court, together with original documents.

Also, if a party against whom an arbitration award has been made is not present during the issue of the award by a foreign arbitration tribunal such party may be deemed not to have been duly served with a notice of such award being made. This could constitute further grounds for refusal by the Russian courts to recognise and enforce a foreign arbitral award.

Recognition of Foreign Courts’ Judgments

When considering applications for the enforcement of a foreign court's judgment, the traditional approach taken by the Russian courts has been to rely on a provision of the Civil Procedural Code and the APC that such judgments will be recognised and enforced in Russia where enforcement and recognition are provided for by an International Agreement of the Russian Federation and Russian Federal Law.

Russia has signed international bilateral agreements on the recognition and enforcement of foreign judgments with 36 countries, 10 of which are CIS countries and most of the rest are former USSR countries. There is currently no bilateral agreement between Russia and the United Kingdom in this respect. However, case law does suggest that Russian courts can and have relied on principles of “reciprocity and comity between nations” to recognise as binding and enforceable judgments of English courts in Russia. In particular, a few recent cases tried at the Supreme Commercial Court have meant positive news for those doing business in Russia or with Russian counterparties. In these cases, the Russian courts have relied on international law principles of reciprocity and comity to rule that a judgment of the English courts is enforceable in Russia.

Under the principle of reciprocity of nations remedies, damages and penalties that are granted by one state to the citizens or legal entities of another are to be returned in kind.

The principle of international comity goes further and provides that one jurisdiction will extend certain courtesies to other nations (or jurisdictions), particularly by recognising the validity and effect of their judicial courts.

One of the first examples of a Russian court enforcing a foreign court’s judgment under these principles was a case of BNP Paribas and others v. Yukos Oil Company. In this case, a Russian court enforced a judgment of the English High Court given in favour of BNP Paribas (the creditors of the former oil giant, Yukos).

In this case, the Moscow Commercial Court held that:

- Russia and the United Kingdom are both members of Council of Europe as well as signatories to the Convention for the Protection of Human Rights and Fundamental Freedoms 1950. The Convention in article 6 provides for a right to a fair trial which, in practice, covers all stages of the hearing, including enforcement and recognition of judgments;
- the Agreement between the Russian Government and the Government of the United Kingdom on Economic Co-operation provides that nationals and legal persons of either country shall receive national treatment with respect to access to and procedure of all courts and administrative bodies in the territory of the other country as claimants, defendants or otherwise in connection with commercial deals; and

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2 Including the decision of the Russian Supreme Commercial Court in Ansell S.A. v. MedBusinessService-2000
3 The Moscow Commercial Court rejected copies of correspondence between the parties as evidence and denied enforcement because the translation of these documents into Russian had not been notarised. The decision was upheld by the relevant court of appeal and the Supreme Commercial Court
4 Boegli – Gravures S.A. against LLC Darsay – ASP and others (2012); Renptul B.V. against LLC Podjemnie Tehnologuy (2009)
the Constitution of the Russian Federation provides that established principles of international law form a part of the Russian legal system and, since there is clear evidence of English courts enforcing the judgments of Russian courts, Russian courts must recognise the judgments of English courts under the principles of reciprocity and international comity.

It should be noted that, when examining whether the decision in the Yukos case would form the basis for future judicial decisions, legal commentators treat the precedent with caution due to it being potentially a politically motivated decision.

As Russia is a civil law country, judicial precedent does not, strictly speaking, have the force of law except for precedents adopted by the Constitutional Court, the Supreme Court and the Supreme Commercial Court which form a source of interpretation of codified law and sometimes the basis of future codified law. Although it remains too early to tell how decisions of the Supreme Commercial Court will be interpreted and followed by Russian courts of first instance, it does have the potential of opening the way for the reciprocal enforcement in Russia of decisions of foreign courts (which would include England, the U.S. and many other countries whose judgments had not been previously enforceable in Russia due to a lack of reciprocal enforcement treaties with Russia).

**Time Limits**

The general limitation period under Russian law is three years. In claims on recognition and enforcement of foreign judgments the period of three years is calculated from the date when a foreign judgment is given or award granted, being the point at which it becomes enforceable.

A contractual term which purports to impose a limitation period shorter than three years will be void.

If an application is made out of time, the defendant would be able to plead the defence of limitation and the applicant would then have the burden of proving that the cause of action arose within the relevant statutory period.

### Recognition of foreign freezing orders and ability to obtain a Russian freezing order

Although the risk of the Russian Guarantor dissipating his or her assets arises before the making of an application for the recognition and enforcement of a judgment, it significantly increases at this stage.

There are several ways of preventing a Russian Guarantor from dissipating his or her assets (at any stage of the proceedings). The most common of these are:

- seeking a freezing injunction against the Russian Guarantor in the English courts. A freezing injunction can be sought in respect of the Guarantor’s assets situated in England, abroad or worldwide ("worldwide freezing order"). The problem with such freezing orders is that in order for a worldwide freezing order for them to be recognised and enforced by the Russian courts, it is necessary for the lender to make an application to the Russian courts for recognition and enforcement of such freezing order and there is no case law on such applications;

- seeking a freezing order in the Russian courts in support of foreign arbitration proceedings. The Presidium of the Supreme Commercial Court in a recent case confirmed that Russian Commercial Courts have the power to freeze assets and grant other interim security measures in support of foreign arbitration (but not litigation) procedures. This is the better option.

The Presidium’s ruling creates a precedent which will serve as a guideline for the lower courts. Parties with assets in Russia will now be aware of the possibility that there could be a freezing order issued by a Commercial Court against their assets in support of foreign arbitration proceedings. The ruling is new law and has not been widely applied in practice yet, hence, whilst it is welcome news for foreign lenders and investors, its impact on how Russian courts of first instance will interpret it remains to be seen.
**Costs of bringing proceedings in Russia**

All costs will depend on the complexity of a particular case and geographical location of the Russian Commercial Court in which proceedings are commenced.

An indicative guide of the level of legal fees a lender can expect to incur is set out in the below table.

<table>
<thead>
<tr>
<th>Action</th>
<th>Estimated cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Application for the recognition of a foreign arbitral award</td>
<td>£20,000 - £40,000</td>
</tr>
<tr>
<td>Application for the recognition of a foreign court judgment</td>
<td>£20,000 - £40,000</td>
</tr>
<tr>
<td>Obtaining a Russian court freezing order</td>
<td>£5,000 - £50,000</td>
</tr>
<tr>
<td>Enforcement by bailiffs</td>
<td>£5,000 - £20,000</td>
</tr>
</tbody>
</table>

As a general rule under Russian law the losing party pays the other side's costs in a reasonable amount. However, if prior to commencement of the court proceedings the parties enter into an agreement for costs the Commercial Court will adopt the rules provided by such agreement.

**Types of Enforcement**

**Court procedure**

If a lender's application for recognition and enforcement of a foreign court's judgment or a foreign arbitral award (see above) is successful, the court will make an order recognising such award/judgment and issue an enforcement order. The lender will then have three years from such enforcement order to initiate an enforcement procedure which is made up of two stages: (1) filing the enforcement order and levy of execution with court bailiffs, and (2) the execution proceedings themselves, which are performed by court bailiffs and consist of the sale of the relevant assets at a public auction by a special organisation connected with the court bailiffs.

The overall procedure can be cumbersome and lengthy, with timeframes and costs difficult to estimate, as both may vary on a case-by-case basis. The bailiff enforcement proceedings usually take a minimum of six months and, in some circumstances, at the request of the Guarantor, the court is entitled (subject to certain conditions) to postpone the sale of the Guarantor's assets for up to a year.

**Out-of-court procedure and self-help**

Under Russian law the parties can enter into a self-help agreement as at the date of the Guarantee or any time thereafter. The self help agreement may be made in a form of a stand-alone document or may be incorporated into a Guarantee as one of its terms and conditions.

Changes in the Russian law which came into force in 2009 provided for a new, out-of-court enforcement procedure, pursuant to which lenders may: (i) acquire (take title to) the Guarantor's assets; (ii) sell the assets directly to a third party or via a commission agent; or (iii) arrange an auction and sell the assets via such auction.

The law dictates that under (ii) and (iii), the sale/transfer should occur at a market price.

In relation to certain assets, particularly real property, when enforcement is made via a public auction, the lender is required to send to the Guarantor a notice requiring the Guarantor to perform the Guarantee and the lender may not commence enforcement proceedings until the Guarantor fails to perform the Guarantee within the time limit prescribed by statute.

Under Russian law, it is also possible for the parties to enter into a self-help agreement at the date of the Guarantee or any time thereafter. The self-help agreement may be made in a form of a stand-alone document or may be incorporated into a Guarantee as one of its terms and conditions. It should be noted that if a lender wishes to rely on self-help, or an out-of-court procedure for enforcement, this must be explicitly referred to in the Guarantee. In the absence of such a provision, the lender will only be able to use the court procedure on enforcement.

Practically, since the Guarantee will be governed by English law, it seems that the most sensible solution would be entering into the stand-alone self-help agreement governed by Russian law (but to include a term in the Guarantee referring to the self-help agreement). Such agreement should be made in the
same form as the Guarantee and, if it relates to immovable property, is subject to state registration.

A self-help agreement can provide for a choice on enforcement between self-help or the court procedure and the existence of the self-help agreement will not deprive a lender of the right to enforce the Guarantee through the courts. It should be noted that, where the lender has a choice between using an out-of-court enforcement procedure and the court procedure, if the matter goes to court, the Russian court will order the lender to pay court costs unless it can prove that it unsuccessfully attempted to enforce the Guarantee out-of-court, or that it is not possible to enforce the Guarantee out-of-court for other reasons.

Russian law contains a number of limitations in respect of self-help agreements, for example:
- self-help may not be available as an option when enforcing against certain types of assets, enforcement in respect of which can only be carried out through a court;
- in certain scenarios, the consent or permission of a spouse or a state authority is required where the enforcement of a Guarantee requires a court decision, for example, where seeking to enforce against jointly owned assets (see below) or in relation to the enforcement of rights under a lease agreement in respect of a plot of land where the lessor’s consent is required; and
- self-help agreements in respect of certain types of assets require the notarised consent of a Guarantor.

Specific Considerations and Practical Issues

Spousal consent

The issue of spousal consent does not arise if the Russian Guarantor owns certain assets separately from his or her spouse and granting the Guarantee does not affect the rights of such spouse. However, if the Guarantor owns all or a part of his or her assets jointly with his spouse (which is often the case), spousal consent is required in order for the Guarantee to be valid. Such consent must be provided under Russian law.

Execution of the Guarantee

It is often the case that the Guarantor will argue the validity of his or her signature on the Guarantee. Since the Commercial Court when considering the recognition of a foreign arbitral award does not look at the merits of the case itself, a question of the validity of a Guarantee would fall outside the Russian Commercial court’s proceedings. However, it is advisable to insist that the Guarantee be notarised in order to avoid any arguments from the Guarantor in relation to its validity.

Russian law legal opinion

Prior to executing the Guarantee a lender should obtain a Russian law legal opinion in which Russian counsel will provide an opinion as to the execution, validity and enforceability of the Guarantee under Russian law and the enquiries made at the relevant Russian authorities in respect the Guarantor’s assets.

The Russian Guarantor’s business activities

When enforcing a foreign judgment or an arbitral award against a Russian Guarantor which connected to a shareholder in either a state-owned entity (e.g. Rosatom State Nuclear Energy Corporation) or an entity in which the Russian Government has a significant shareholding (e.g. Sberbank, OJSC Gazprom) or which has material government contracts (e.g. former RAO UES companies) there will always be a risk of such recognition being denied on public policy grounds. The lender should monitor closely the economic and political situation in Russia since certain changes in the political climate will sometimes trigger a change in the ownership of certain assets from private ownership to ownership by the state.

Conclusion - arbitration or court proceedings?

The other possibility is to include a “submission to the English courts” jurisdiction clause. Whilst the recent Yukos case may offer some comfort to the lender that the Russian courts may enforce a judgment of the English courts, our view is that it would be unsafe for the lender to rely on the decision in this case as it may not necessarily be followed by the Russian courts of first instance until it is codified and has the force of law in Russia.

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