



Arbitrazh courts: the long road back from Yukos

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Overview

The Putin administration has given high priority to judicial reform, including Russia's commercial ('arbitrazh') courts. This shows an understanding that dependable enforcement of contract and fair dispute resolution are essential for the investment climate and the country's overall modernisation. But the arbitrazh courts were tarnished by the Yukos affair. As our trusted source argues from her excellent professional vantage point, that reputational damage is hard to repair. But continuing reform efforts - especially to promote greater transparency and accountability of judges - are on the right lines.

Context

The framework exists; will the reform make it more efficient?

Wrap

Two steps forward, one step back

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Greater use of technology will improve efficiency, and the quality of the judges is high. But the YUKOS case looms large in the background

- > **Olga Schwartz**, Legal Consultant to World Bank, Moscow Office

Context

It was only after the break-up of the Soviet Union that it was recognised that a specific commercial court system was needed. Commercial courts had existed in pre-revolutionary Russia, but with no private enterprise permitted in Soviet times there were no capitalist-style commercial disputes. The current 'arbitrazh court' system came into operation on 5 March 1992. The Russian term *arbitrazhny* does not connote arbitration as a term of art in international legal practice. It is more accurate to think of these as straightforward commercial courts, and they are often referred in English using the Russian term as 'arbitrazh courts'.

Structure of the arbitrazh court system

The courts of first instance are to be found at the regional level - and now present in 82 of the Russian Federation's 86 regions. The next level up is the appeal court: by the end of 2007, there will be 20 of these throughout the country. If the appellant or defendant is not satisfied with the outcome, they can take the case to the Federal Arbitrazh Court, which acts as the court of cassation. The final level of appeal is the Supreme Arbitrazh Court (SAC), which also administers the whole system. To take a case beyond the cassation court to the SAC, litigants must first demonstrate to a committee of SAC judges that a point of legal principle is at stake.

The growth of private business in post-Soviet Russia has led inevitably to a growth in commercial disputes. There are now 3,500 judges in the arbitrazh system and the number of cases they hear has been growing at around fifteen percent per annum, reaching 1.5m cases in 2006. Even so, there were an estimated 1.2m cases pending at the end of 2006.

Chronology of a successful arbitrazh claim

6 Aug 2003: Google Inc filed a claim with the Moscow City Arbitrazh Court over the domain name, *google.ru*. Although the name had never belonged to Google Inc, the company claimed that the name and content of the site had been deliberately chosen to give the impression that the site was a Russian version of *google.com*, and thus claimed infringement of its trade mark

22 Oct 2003: The Moscow court decided in favour of Google Inc, and ordered the defendant to cease using the Google name. The defendant turned to the Court of Appeal, claiming, among other points, that it did not offer on its site the sort of services provided by Google Inc

14 Jan 2004: The Appeal Court rejected the defendant's claims, upholding the initial ruling. The defendant appealed to the Cassation Court, simultaneously suspending the enforcement of the Appeal Court's decision to transfer the domain name *google.ru* to Google Inc

27 Feb 2004: The Federal Arbitrazh (Cassation) Court upheld the ruling of the two lower courts. The defendant did not take the case to the Supreme Arbitrazh Court

4 Mar 2004: This definitive ruling was enforced with the cancellation of the *google.ru* domain, allowing Google Inc to register the domain name

NB: This case was resolved and enforced within seven months, which is unusually swift. Many cases take twice this time

As may be expected with any new institution, the arbitrazh court system since its instigation has been subject to a number of changes - some fine-tuning, others more radical. Two stand out.

A new appeals circuit was established in 2003, physically and institutionally separate from the

previous appeal courts which existed under the same roof and staffed by the same team of judges as the courts of first instance in regional capitals. That previous system made appeal rulings subject to the same local bureaucratic and allied business interests.

In 2004, the retirement age for arbitrazh court judges was set at 65 years. This led to the departure that year of the first Chairman of the SAC, Venyamin Yakovlev. Yakovlev's qualifications and experience were not matched by his much younger successor, Anton Ivanov, who appeared to owe his appointment to the fact that during the 1980s he was a classmate of Dmitry Medvedev (now the frontrunner for the presidential succession) in the Leningrad University Law Faculty (which is also President Putin's alma mater).

In spite, or perhaps because, of being a political appointee, Ivanov has continued the reforms of the arbitrazh system begun during Putin's term. The box below summarises the main measures.

This reform process has been assisted by advice and finance from abroad - notably from the World Bank, and also an effective partnering programme with the US Judiciary. Significant domestic resources have also been committed to judicial reform. From 2002 to 2006 there was a Rb44.9 billion 'Federal Targeted Programme' in this area; and this sum has been increased by Rb4 billion rubles for the second programme for 2007-2011. These programmes are aimed at improving the independence of judges and raising public confidence in the judicial system as a whole.

Key reforms of the arbitrazh system during Putin's Presidency

2000: Then Deputy Head of the Presidential Administration, Dmitry Kozak, tasked with drafting legal reform. Major points which were enacted were:

- pay for judges and court officials significantly increased, in a bid to remove one of the main reasons given for corruption of the judiciary (average monthly salary at the start of 2007 is Rb85,000 = \$3,200)
- greater accountability of judges, including declaration of income
- enactment of the Arbitrazh Procedural Code, removing the right of the Prosecutor's Office to intervene in commercial litigation between private parties where there was no state interest
- creation of the 20 district appellate courts; before this, appeals were heard in the same court of first instance (though before a different judge)
- refurbishment/reconstruction of court buildings, including provision of video-conferencing links in all courts

Much of this was carried out under the aegis and with the funds of the 2002-2006 Federal Targeted Programme, for which a budget was allocated of Rb44.8 billion rubles (\$1.7 billion)

When Kozak was appointed Government Chief of Staff in March 2004, responsibility for reform of the arbitrazh system passed to the Chairman of the Supreme Arbitrazh Court (SAC)

- Ivanov's main aim as SAC Chairman has been to improve the use of technology, notably by making court proceedings available online: the lack of a trial transcript hindered greatly the chances of an appeal court giving a fair hearing
- to increase further the accountability of judges: not only income but all gifts received by a judge of a value over Rb4,000 (\$150) must be declared

- lobbying of judges to be a disciplinary offence
Funds for these reforms will come under the 2007-2011 Federal Targeted Programme

As far as the investment climate is concerned, a highly important aspect of the arbitrazh courts' performance is the handling of disputes between companies and the tax authorities. It is in this area that the system suffered its most serious setback. For the battleground chosen by the authorities in 2003 for their attack on Yukos was taxation. And the result was that the arbitrazh court system was mobilised at all levels to hand down rulings upholding the gigantic back tax claims which destroyed the shareholders' equity in that company.

Despite this blow to the courts' reputation and credibility, 70% of cases arising out of disputes between the tax authorities and company taxpayers are won by taxpayers (that figure was provided by the SAC as an average in 2006).

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Even though the current Chairman of the Supreme Arbitrazh Court, Anton Ivanov, does not have the authority of his predecessor, Venyamin Yakovlev, he is overseeing technical changes, including much greater use of information technology. It is Ivanov's aim that all decisions of the arbitrazh courts should be available online. This is designed to improve transparency which should, in turn, make the judicial system more efficient.

Ivanov is encouraging litigants to file their cases on the Internet, which will make it easier for interested parties to follow cases, and also make the courts more accountable for reaching decisions quickly. Problems exist, though. There is still no standard formula for filing cases online (by defendants, by witnesses etc) and no satisfactory search facility has been established for comparing cases. Ivanov has asked for extra finance to improve the system; it is hoped that some of the extra 4bn rubles in the Federal Targeted Programme for 2007-2011 will be used for this.

The quality of judges in the arbitrazh system is considered to be higher than in other areas of the judicial system; there is more experience and they are better qualified. There is also continuity of service, with none of the regional arbitrazh judges having been replaced. This continuity and experience is particularly important, given that there is no jury system in the arbitrazh courts. However, it is fully accepted that arbitrazh judges can call in lay people, such as tax specialists, to assist them with technical decisions in a case. Two specialists may sit alongside the judge to help him or her reach a decision.

Ironically, though, there is little public perception of the arbitrazh system, as the majority of the population - who have a very poor opinion of the general courts, seeing them as corrupt and unrepresentative - have no contact with it. It is only business people who are likely to have contact with the arbitrazh courts; but they do not have a high opinion of the system.

This is, firstly, because of the sums of money which can be involved in arbitrazh cases, it is well known that bribes in the arbitrazh system tend to be higher than elsewhere. Also, it is known that judges will often obey the instructions they receive from the regional administration. And there has been one vivid example of how the arbitrazh system has been used for political ends: the Yukos case.

Until the arbitrazh system was used to prosecute Mikhail Khodorkovsky and dismantle the Yukos oil company, entrepreneurs tended to be favourably inclined towards it as it was not considered to be subject to political pressure. But that case showed that the arbitrazh system was not immune to political pressure, especially after the first judge who defended Khodorkovsky was then removed.

The only thing which may now restore some faith in the system among businessmen will be if Ivanov's reforms bring positive results. Declaration of judges' income and assets should reduce corruption; and online publication of court transcripts should provide greater transparency.

Wrap

Two steps forward, one step back

With President Putin and many of those in his inner circle having legal training, it follows that greater attention should have been paid to the judicial system in general than in the chaotic 1990s; and, with the growth of business, to the arbitrazh system in particular. The material increases in judges' salaries reflect an understanding that poorly paid judges are more likely to be open to corruption.

Olga Schwartz's comments on Ivanov reflect the collective raising of professional eyebrows caused by this political appointment combined with the legal community's perception that his reforms have positive potential. The use of the internet for transparency is particularly significant. Accessible records of all hearings will make it more difficult for the rulings of corrupt and/or incompetent judges to be lost in the system. As in almost all areas of Russian public life, any advances in accountability are highly welcome.

As Ms Schwartz indicates, the reputational damage to the arbitrazh courts from the Yukos affair will not be easily repaired. And while there has been no repeat since of that blatant political interference, even now there are instances of the tax authorities exerting undue influence on the courts. Ivanov himself has complained at least two cases in 2006 of judges being removed following pressure from the tax service on the judicial appointments body.

Next tests: implementation of the Ivanov reforms

Quality control of arbitrazh court rulings (independence from political influence, bribes and intimidation) improved after all decisions are published online.

Improved efficiency of the arbitrazh courts resulting from online filing of actions.