

# **A View of the Problem of Corruption in the Russian *Arbitrazh* Court System**

**Kennan Institute  
May 31, 2005**

**Ethan S. Burger, Esq.  
Scholar-in-Residence  
School of International Service  
Adjunct Associate Professor, Washington College of Law  
American University  
Washington, D.C. 20016**

**[ethansb@american.edu](mailto:ethansb@american.edu)**



# Preliminary Thoughts

- Putin's Rule of Law vs. Dictatorship of Law.
- The trend is toward the elimination of the judiciary as an independent branch of government.
- “Funded” research often generates unreliable or inaccurate findings (what is the funding source, who are conducting the surveys, is the research model valid?)
- The nature of the dispute must be defined before generalizations are made.

# Structure of the Russian Court System

- *Arbitrazh* [Commercial Courts]  
(Supreme, Circuits (10), and Courts of First Instance).
- Courts of General Jurisdiction  
(Supreme, RF Subjects, District, Peace (less than \$350 at stake)).
- Constitutional Court.

# Dynamics of Court Appointments

- Judges are appointed by federal order (but must pass a qualifying exam).
- Federation Council (now appointed by President) must confirm judges for the Constitutional, Supreme and Supreme *Arbitrazh* Court.
- 3-year term initially, but then reappointed for unlimited term, until judge reaches age 65).
- Appointment of Judges allegedly overseen by Victor Ivanov (former Soviet KGB official) – is this leading to KGB, MVD and procuracy personnel becoming judges?
- Consequently, the President largely controls the courts.

# REMEMBER ARTICLES V OF THE 1958 NY CONVENTION ON THE RECOGNITION AND ENFORCEMENT OF FOREIGN ARBITRAL AWARDS NOT ALWAYS A REALISTIC OPTION IN RUSSIA

## *Article V*

1. Recognition and enforcement may be refused, if:
  - (a) Some incapacity or agreement not valid under applicable law; or
  - (b) Improper notice or unable to present case; or
  - (c) Dispute not to be submitted to arbitration; or
  - (d) Problems with composition of the arbitrators or arbitral procedure; or
  - (e) Invalid award (misc.).
2. Recognition and enforcement may also be refused if the competent authority in the country where recognition and enforcement is sought finds that:
  - (a) The subject matter of the difference is not capable of settlement by arbitration under the law of that country; or
  - (b) The recognition or enforcement of the award would be contrary to the public policy of that country.

# Adopting Laws is a Good Start, but . . .

- Law on the Russian Federation No 5338, “On International Commercial Arbitration,” July 7, 1993,“ Articles 35 and 36.
- Federal Law No. 118-FZ, “On Judicial bailiffs (*Pristavy*)”, July 21, 1997, as amended).
- Federal Law No. 119-FZ “On the Executive Procedure”, July 21, 1997 (as amended.
- Federal Law No. 96-FZ, “Bringing into Action the Arbitration Procedure Code of the Russian Federation ,” July 24, 2002.
- Article 3. Federal laws and other normative legal acts effective on the territory of the Russian Federation and connected with the Arbitration Procedure Code of the Russian Federation shall be brought into line with the Arbitration Procedure Code.
- Arbitrazh Procedure Code – Chapter 31- Proceedings on Cases on the Recognition and Execution of Decisions of Foreign Courts and of Arbitrazh Decisions. **Does this not go beyond the 1958 New York Convention?**

# The Roadmap for Enforcing Judgments Under the Arbitrazh Procedure Code

- Decision of the Plenary Session of the Higher Arbitration Court of the Russian Federation No. 11, “On Certain Questions Associated with the Enactment of the Arbitration Procedure Code of the Russian Federation,” December 9, 2002.
- “Statements of claim and other applications shall be accepted and cases examined proceeding [in] cases of economic disputes ... arising from civil, administrative and other public legal relations and also all cases of economic disputes . . . with foreign nationals' participation, the cases of disputing the awards of the courts of arbitration and of international commercial arbitration on disputes arising from entrepreneurial and other kinds of economic activity, on the issue of writs of execution for enforcement of such awards, the cases of recognition and execution of judgments passed by foreign courts and of foreign arbitration awards on disputes arising from entrepreneurial and other kinds of economic activity.”

# President Putin's Perplexing Televised Remarks After the Beslan Tragedy, September 2004

“We all expected changes, changes for the better, but found ourselves absolutely unprepared for much that changed in our lives. The question is why. We live in conditions of a transitional economy and a political system that do not correspond to the development of society. We live in conditions of aggravated internal conflicts and ethnic conflicts that before were harshly suppressed by the governing ideology.”

“We stopped paying due attention to issues of defense and security. We allowed corruption to affect the judiciary and law enforcement systems. In addition to that, our country, which once had one of the mightiest systems of protecting its borders, suddenly found itself unprotected either from West or East.”



# President Putin's Comment on the Russian Judiciary in his April 25, 2005 Address to the Federal Assembly

- “[I]f part of Russian society continues to see the court system as corrupt, there can be no speaking of an effective justice system in our country.”
- “Overall, I want to note that we need principally new approaches to fighting crime in our country. The relevant decisions will be prepared.”

# A Rule of Law ? ? ?

- Yukos is **NOT** the norm, (e.g. Tax investigations into 2001 tax payments by oil firms Slavneft, Rosneft, Sibneft and Tatneft, ended with an order that TNK-BP pay \$87 million), but . . . Vimpelcom? **DON'T IGNORE THE FACT THAT THE SOVIET/RUSSIAN HUMAN RIGHTS ALMOST ARE UNITED IN THEIR SUPPORT OF KHODORKOVSKY.**
- Russian Governmental Actions have consequences: Societe Generale and ING stunned investors in August by pulling out of a high-profile loan deal to TNK-BP [50% UK-owned] (FT, Sept. 4, 2004)
- IMP International (Canada) vs. Aeroflot over Aerostar Hotel [FT, April 3, 1998; Toronto Star August 18, 2004].
- Sawyer Research Inc. (U.S.) in Vladimir Oblast [Cleveland Plain Dealer, June 24, 2002].
- Euro Asia Investments (US) v. local authorities and its investment in Primorkhlebproukt (FT Aug. 15, 2002).

## Some Factors Contributing to Judicial Corruption

- A new approach: deprived judges of free apartments, but increased salaries (highest salary now R27,000/month or approximately \$1,000; lower level officials (formerly \$280-300), who are capable of misplacing files or altering documents can earn much less).
- Judges sometimes hear disputes where millions of dollars are at stake.
- Judicial decisions are usually not published, judicial practice remains haphazard (though Supreme *Arbitrazh* Court has been issuing better “informational letters”), and there are inconsistencies in attitudes towards the imperatives of substantive and procedural dictates.
- Judicial salaries remain far behind those available in the high-end of the market economy.
- **Note that corruption is far less of a problem where the dispute doesn’t involve a lot of money.**

# Methodologies for Results-Oriented Decision Making

- Judges review case and determine which side should prevail on the merits and then seek bribes to issue appropriate ruling.
- Judge rules in favor of the highest bidder.
- Judge follows the dictates of state officials or members of organized crime.

# Reform: Don't Be Fooled by the Word !!!

- Russian Federation's "Development of the Judicial System in the Period up 2006" but will the money be there?
- Improvements in quality and quantity of documents on specific cases – important for judges and private attorneys.
- The court system remains underfunded.
- Creation of advisory bodies to combat corruption pursuant to Presidential Edict #1384, November 2003 – timing is suspect (before State Duma Elections and start of Presidential campaign).

## Are All Results Tainted?

### There are Numerous Factors To Consider

- If the *arbitrazh* courts are so corrupt, why has the number of cases doubled over the last 10 years?
- Efforts are being made to improve transparency and improve court administration.
- Training of judges has improved, but will trained judges stay?
- Private citizens have frequently prevailed against the government, but what about significant cases?
- All transitions take time and Russia is no exception.
- Judicial corruption is universal even in some U.S. state courts.

# What Does the Russian Public Think?

- The All-Russian Center for Public Opinion Study (VTSIOM) published results of a poll in the course of which Russians evaluated efficiency of combating of corruption. According to the poll, 65% of respondents believe that it is impossible to defeat corruption in Russia and only one-third (30%) of respondents believe in success of struggle against this social evil.
- Two-thirds of respondents say that local authorities and law-enforcement agencies are the most corrupt state institutions. A little more of respondents believe that "the whole society" is corrupt. According to VTSIOM, 20% of respondents see the main bribe-takers in the judicial system and federal power bodies, 10% believe that large business, healthcare system, education system and military registration and enlistment offices are corrupt. The number of respondents criticizing mass media, parliament and political parties is the smallest.

## What the RF Qualification Commission Data Show: Table 1 Complaints, etc. Received

<u>Year</u>	<u>Number</u>
1996	1839
1997	2740
1998	3655
1999	4740
2000	5463
2001	5950
2002	6993

*Vestnik Vyshei kvalifikatsionnoi kollegii sudii Rossiiskoi Federatsii* [Herald of the Higher Qualification Collegium of the Courts of the Russian Federation, Issue No. 2, 2003, Annexes 1-5.



# Judges Forced Off the Bench

<u>Year</u>	<u>Number</u>
1994	67
1995	50
1996	96
1997	75
1998	115
1999	92
2000	75
2001	45
2002	36

# Official Reasons for Removal

- (i) violation of work discipline (13%);
- (ii) falsification of judicial documents (12%);
- (iii) other violations of the Judicial Code of Honor (8%);
- (iv) violation of substantive and procedural legislation of the Russian Federation (53%);
- (v) red-tape [presumably inefficiency] (14%)

# A Lack of Candor at the Top of the Russian Arbitrazh Court System?

According to newly-appointed Russian Supreme *Arbitrazh* Court Chairman Anton Ivanov:

- Argues that the extent of corruption has been exaggerated.
- Nonetheless, It is impossible to completely defeat corruption, but it can be reduced.
- Suggests the concerned parties should create a system for applying judicial practice; such a system would stipulate clear-cut positions on various cases, he stressed. Consequently, fewer loopholes would remain for biased verdicts.

# Chairman Vyacheslav Lebedev, of the Russian Supreme Court Publicly Denies There is a Problem

- With respect to corruption in the Russian judicial system in Russia, he declared:
- "This is a very unfounded statement that corruption has allegedly penetrated the judicial system. Such rhetorical cliches do not correspond with the real state of affairs. Yes, there are separate facts of bribery, but no corruption... Sometimes we throw around words too easily and do not understand that this discredits justice, the highest value in society. And some people discredit the judiciary on purpose."

# But The Russian Authorities Do Not Speak with One Voice

- Arkady Dvorkovich, Head of the Presidential Administration's Expert Department, thinks that the problems of corruption, administrative barriers and effective work of the judicial system haven't been solved in Russia yet.
- Constitutional Court Chairman Valery Zorkin believes that the Russian courts are rife with corruption. "Bribe-taking courts have become one of the largest corrupted markets of Russia. Research shows that courts are quite vulnerable to corrupted attacks by business," meaning corrupt courts are part of a bigger system which can help unscrupulous businessmen or aid in the acquittal of the guilty.
- Zorkin called for "[f]urther reform [the development] of courts is unthinkable without a comprehensive legal reform in Russia. I am confident that all the other reforms will slow down pretty soon if the legal reform is not given a boost."

# Appraisal by One Who Should Know

- Dmitrii Kozak is currently the Southern Federal District Plenipotentiary and widely regarded as the major advocate of judicial reform.
- His recent observations include:
  - the judicial system must be overhauled;
  - it is impossible to find justice there;
  - one cannot hope for economic and political progress at a time when people do not believe in the judicial system;
  - the present day judicial system has turned into a veritable business where large enterprises are trying to delegate their representatives into the judicial system.

Source: Novosti January 27, 2005

# The Views of Some Legislators

- Speaker of the Federation Council Sergei Mironov -- the Supreme Qualification Commission of Judges and heads of the Court Department [should] be appointed on the President's recommendation and approved by the Federation Council. What is the point of the judiciary being dependent on the executive branch?
- First Deputy Speaker of the Duma Lyubov Siska -- “[w]e cannot afford to throw another branch of power into disarray. This branch has to be reformed delicately and carefully. It might be a good idea to appoint head of the Court Department by presidential decree in order to hold him accountable for his work. However, judges' independence should be approached with more caution.”
- Duma Member Irina Khakamada -- “[t]he thing is that the president appoints all the ministers and [agency] heads too, but admits that corruption in the power structures has reached unprecedented levels. Therefore, the appointment principle has nothing to do with the drive against corruption.”

# The Need for Systemic & Attitudinal Change

- Former Arbitrazh Court Chairman Veniamin Yakovlev saw corruption as more of a problem than his successor.. He called for the creation of new appellate system where the appeals courts are physically separated from the trial courts. Furthermore, he observed that a random, computerized system of assigning cases to judges, rather than the existing system where cases are allocated base on caseload and specialization of the judges, may serve to reduce judicial corruption.
- It cannot be overlooked that combating corruption is not merely a question of enacting laws, developing codes of ethics, and establishing training programs for judges. It requires a change in governmental and societal attitudes, greater transparency, effective training and genuine accountability, where penalties for transgression are severe and fairly imposed, irrespective of political considerations. It also demands a willingness to commit sufficient resources to implement anti-corruption programs. At present, only a confirmed optimist is likely to believe this will occur in the near future, though others may have their motivations to state otherwise.



# U.S. Govt is Finally Speaking the Truth (well sort of) about the Problem of Russian Judicial Corruption?

Generalizing about the quality of the Russian judiciary is difficult. This situation has been noted by U.S. Ambassador to Russia Alexander Vershbow:

“ there is a troubling pattern in many regions - the conflict of interests at the municipal and oblast levels of government that work to keep out competitors. This tendency is exacerbated by the weak and often corrupt judicial system that fails to uphold court decisions. This is an all too frequent element in long-standing investment

Disputes involving foreign investors. At the federal level, policies are often pursued to support the interest of specific firms at the expense of competitors.”

In the U.S. Ambassador’s view, a foreign investor may be unable to receive a fair hearing of its case on the merits. That being said, even within a given judicial district, the quality of Russian judges from both a substantive and ethical standpoint is highly variable

# Disquieting Report of the Council of Europe's Parliamentary Assembly

“The Assembly stresses the importance of the independence of the judiciary and of the independent status of judges in particular, and regrets that legislative reforms introduced in the Russian Federation in December 2001 and March 2002 have not protected judges better from undue influence from the executive and have even made them more vulnerable. Recent studies and highly publicized cases have shown that the courts are still highly susceptible to undue influences. The Assembly is particularly worried about new proposals to increase further the influence of the President's administration over the judges' qualification commission.”

Point 6 from Report: “The circumstances surrounding the arrest and prosecution of leading Yukos executives.”  
(November 2004)

# Is there Discrimination Against Foreign Companies?

## Two Completely Opposite Views:

- U.S. attorney Glenn P. Hendrix participated in a study purporting to show that there was not evidence of discrimination against foreign legal entities. But his admitted limitations about the data raises questions about his conclusions.
- Speaking at an OECD Conference entitled “Corporate Governance in Russia,” another U.S. attorney, Jeffrey N. Hertzfeld, indicated that the estimate that 70% of the cases heard by Russian courts Russia [presumably “high stake” commercial disputes] are determined by bribery.
- Former World Bank Head James Wolfensohn stated that one of the “biggest obstacles to the development of legal and judicial systems [was] a situation where economic elites use the system in their own interests.”

# Learn How to Play the Game

- Remember that small, medium and large enterprises are not treated the same – only large enterprises create a significant volume of jobs and a reliable source of tax revenue).
- Russia regional officials vary in their goals and compete for FDI, but less so than in the past.
- Build relationships with a range of authorities (it is hard to predict who will be an ally). Make “political” hires (but remember both FCPA and Russian domestic rules on who qualifies as a family member).
- “Informal” dispute resolution should be tried first – it will provide insight as to whether there is a legitimate dispute or merely the pretext of one.

# Protect Yourself ! ! !

- Establish escrow accounts off-shore if one's counterpart does not have assets abroad.
- Be very careful in establishing security interests (pledges).
- Perform careful due diligence and think out one's exit strategy before beginning.
- Remember written agreements are “constitutions” not “contacts” – a road map for business relations.
- Memorialize – create a paper record (for counterpart, court, Russian authorities, U.S. Government, etc.)

# Final Practical Guidance

- Let Russian lawyers take the lead in judicial proceedings in Russia (though give them clear direction).
- Many Russian judges are not sophisticated about commercial matters – remember to educate (also remember that *ex parte* communications are allowed under Russian law).
- Make judge aware of possible consequences for making a decision not on merits (e.g. driving away investment/tax base; personal charges of corruption lodged, etc., but “make this known in a “non-threatening” manner).
- Play the “check & balance game” if possible (Ministry of Internal Affairs, Procuracy, Local and Federal Administration, Appeals Judges, Judicial Qualifications Commission, foreign chambers of commerce, etc.)