

Arbitrability of Commercial Disputes in Ukraine

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When entering into commercial contracts with Ukrainian partners or acquiring corporate rights in Ukrainian entities, many foreign investors/companies prefer to avoid possible litigation in Ukrainian courts. As the most acceptable alternative for the latter is international arbitration, they normally face the question as to whether any and all the disputes arising out of or connected with such a contract may be referred to arbitration, i.e. are arbitrable. At the same time, to avoid any potential problems the issue of arbitrability should be analyzed under the “triple criteria test”: (i) national law of each party to a contract, (ii) law of the place of arbitration and (iii) law of the place of the probable enforcement of arbitral award. Evidently, Ukrainian law should be tested under if not all the criteria but always under criterion (i) and most often under criterion (ii) also, and thus, the provisions of Ukrainian law are fraught with major risks for future arbitration and enforcement of an arbitral award.

Legal Background

Ukrainian legislation does not provide either for definition of disputes’ arbitrability or an exhaustive list of the disputes which are not arbitrable. Therefore, each particular case should be carefully studied subject to the applicable provisions of Ukrainian law and due to obvious reasons this could not be done within the framework of an article. Thus, this article will focus only on the most problematic and controversial issues of arbitrability under Ukrainian legislation.

To date the following Acts set out basic provisions on arbitrability of disputes in Ukraine: the *On International Arbitration Act of Ukraine (Arbitration Act)* and *On Commercial Procedure Code of Ukraine (CCP)*. The application of Article 77 of the *On Private International Law Act of Ukraine (PIL Act)* to the issue of arbitrability is still disputed among some legal practitioners, although this article has nothing to do with arbitration.

In general the arbitrability of commercial disputes is determined in the *Arbitration Act* (Article 1), setting forth that the following may be referred to international commercial arbitration:

- disputes resulting from contractual and other civil law relationships arising in the course of foreign trade and other forms of international economic relations, provided that the place of business of at least one of the parties is situated abroad; as well as
- disputes arising between enterprises with foreign investment, international associations and organizations established on the territory of Ukraine; disputes between the participants of such entities; as well as disputes between such entities and other subjects of the law of Ukraine.

The CCP (Article 12 (2)), in its turn, contains restrictions and prohibits submitting to arbitration (both domestic and international) the following disputes falling within the jurisdiction of commercial courts of Ukraine:



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- disputes on invalidation of acts,
- disputes arising out of conclusion, amendment, termination and performance of public procurement contracts,
- disputes arising out of corporate relations between a company and its participant (founder, shareholder), including a former participant, and between the participants (founders, shareholders) related to the establishment, activity, management and termination of the company.



While negotiating an arbitration agreement it is highly advisable to check whether all potential disputes can be submitted to international arbitration so as to minimize the risks related to applicable legislation and court practice on arbitrability.



Corporate Disputes

In fact in many jurisdictions the issue of arbitrability of corporate disputes is quite controversial.

It can be noted that provisions of the *Arbitration Act* and of the CCP on arbitrability of disputes between the participants of Ukrainian companies (with foreign investment) are opposite.

So, the question is what should prevail? Both are of equal legal force. The *Arbitration Act* is evidently more special in issues of arbitration. But the CCP may be considered as a later Act, as this category of disputes was added to the CCP list of non-arbitrable disputes only in March 2009, while Article 1 of the *Arbitration Act* remains unchanged since 1994. When evaluating the risks of referring to arbitration with such a dispute it should be borne in mind that even if the Arbitral tribunal finds such disputes arbitrable and renders an award thereon, the latter will most probably be submitted to a local Ukrainian court for obtaining an enforcement permit and writ of execution and so Ukrainian court practice must also be taken into account.

The latter took a definite “non-arbitrable” approach in corporate disputes in the last two years and even before the amendment of the CCP. At first, on 28 December 2007, the Presidium of the Higher Commercial Court of Ukraine issued Recommendations *On Practice of Legislation Application in*

the Disputes arising out of Corporate Relations (Recommendations), quite broadly prohibiting the resolution of corporate disputes with regard to a Ukrainian company through arbitration. Then, on 24 October 2008 the Supreme Court of Ukraine issued the Resolution *On Court Practice of the Corporate Disputes Consideration*, specifying that only corporate disputes related to the activity of a company registered in Ukraine and, in particular, arising out of corporate management, are not arbitrable regardless of the shareholding structure. Then, on 18 June 2009 the Recommendations were amended and now they specifically set out that relations on the turnover of shares, except for relations concerning realization of the preemptive right to acquire shares, shall not be deemed as relations concerning the activity of the company and its corporate management. Thus, such category of disputes arising out of share purchase agreements is still arbitrable.

Disputes arising from Public Procurement Contracts

It should be noted that the CCP list of non-arbitrable disputes operates with the term “commercial contracts related to satisfaction of the state’s needs”. However, neither the CCP nor other Acts of Ukraine provide for definition of those “state needs” and respective contracts leaving the possibility of their broad and obviously “non-arbitrable” interpretation by Ukrainian courts. To date Ukrainian legislation (*On Public Procurement for Satisfaction of the Priority State Needs Act of Ukraine* and by-laws issued by the Cabinet of Ministers of Ukraine) defines the term “priority state needs” and sets out that such needs are to be satisfied through public procurement, i.e. through entering into corresponding “state contracts” with legal entities of any form of property (Public Procurement Contracts). The peculiarities of such contracts are provided for in the *Commercial Code of Ukraine* (Articles 13 and 183). The main, but not the only, source of financing of the payments under Public Procurement Contracts is the State Budget of Ukraine. The circle of possible customers under the Public Procurement Contracts is quite wide and includes not only state and municipal bodies, but also certain state enterprises and institutions. In view of the above, as well as legislative gaps in regulating the procedure of entering into Public Procurement Contracts, foreign companies should use greater caution while negotiating an arbitration agreement with such state entities.

Disputes arising between Companies with Foreign Investment and Disputes between such Entities and other Subjects of the Law of Ukraine

The ability of a dispute to be submitted to international arbitration depends not only on its subject matter, but also on the legal status of parties entering into an arbitration agreement. In the majority of jurisdictions in the world a dispute with arbitrable subject matter could be referred to international arbitration if it involves at least one foreign party. However, some national laws on arbitration, including the *Arbitration Act*, took a broader approach and allow the arbitration of disputes even between domestic/local entities with foreign investment or between such entities and other local legal entities/individuals. Pursuant to the *Commercial Code of Ukraine* (Article 116), a legal entity has the status of an enterprise with foreign investment when foreign investment constitutes at least 10% of its authorized capital. Thus, such entities may choose between domestic and international arbitration when

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entering into contracts with other Ukrainian entities/individuals. In choosing the latter, it should be taken into account that the *Arbitration Act* in this part applies only within the territory of Ukraine. In other words there is no problem if such parties refer their dispute to *ad hoc* arbitration or an arbitration institute in Ukraine. But if they decide to submit it to arbitration in another jurisdiction (e.g. to the ICC, SCC, etc.), then they should also check whether the chosen arbitration rules, legislation of the place of arbitration and of the place of possible enforcement of the award allows arbitration of disputes between parties from the same jurisdiction. In the event of a foreign arbitral award between such parties being enforced in Ukraine there is a risk of narrow interpretation of provisions of the *Arbitration Act* by Ukrainian courts as permitting international arbitration between such parties only within the territory of Ukraine. Consequently, there is a risk that recognition and enforcement of such arbitral award could be denied.