

Outsourcing Law in Post-Soviet Russia

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This article looks at a specific phenomenon that has marked Russia's legal development as an open market economy since 1992: the dominant use by Russian economic actors of corporate and contractual structures governed by foreign law instead of Russian law for a substantial portion of their activities and the adjudication of large Russian commercial disputes in foreign venues rather than in domestic venues. Russian economic actors have been extraordinarily busy users of foreign legal infrastructure. During this period there was, in fact, a hefty Russian demand for commercial law and legal services, but instead of being directed towards Russian domestic law and legal infrastructure, much of this demand was outsourced to foreign lawyers and foreign legal infrastructure. The Russian political structures and domestic legal community allowed the outsourcing and in some ways encouraged it, in an implicit consensus that Russian law was not (or not yet) able to serve the needs of large Russian businesses.

In a globalized world, the use by economic actors of foreign law, foreign courts, and foreign corporate structures is a common form of private ordering of transnational activity.¹ It is obviously not unique to Russia. What seems unique in Russia is the extent of the outsourcing and the fact that it affected not just transactions between Russian and foreign economic actors but also entire segments of domestic activity that were structured specifically in order to use foreign legal infrastructure rather than domestic infrastructure. The insufficient protection of property rights by Russian law and the discretionary use of Russian law as a weapon for political ends are well known themes that have already been widely examined.²

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¹ Jürgen Basedow, *The Law of Open Societies: Private Ordering and Public Regulation of International Relations: General Courses on Private International Law*, 360 COLLECTED COURSES OF THE HAGUE ACADEMY OF INTERNATIONAL LAW 135 (2012).

² See, e.g., Jordan Gans-Morse, *Threats to Property Rights in Russia: From Private Coercion to State Aggression*, 28 POST-SOVIET AFFAIRS 263 (2012);

This paper will look at Russian legal development not as a domestic object existing in isolation, but as a developing system co-existing and in essence competing with more advanced and efficient systems that were easily accessible by Russian economic actors. Access to globalized legal infrastructure enables economic actors to “opt out” of domestic infrastructure and turn to foreign infrastructure that they perceive to be better equipped to help them achieve their purposes. These choices reflect the powerful effects of regulatory competition in the provision of law as an exportable service, but not without consequences, however, on the ability of domestic laws to evolve and improve.

Regulatory competition has been widely examined in the United States in connection with corporate charters or contractual choice-of-law; it has also been examined in the European Union as between the member states.³ Russian legal outsourcing illustrates the effects of regulatory competition in the areas of contract law, corporate law, and commercial dispute adjudication between, on the one hand, developed jurisdictions with sophisticated legal institutions (mainly in the EU and British controlled offshore territories) for which transnational commercial legal services are a successful export, and on the other hand a jurisdiction with developing laws and legal institutions in which substantial concentrated wealth was created in a very short time (Russia). Throughout the last two decades, Russian law evolved too slowly to be competitive and yet was wide open, i.e., its substantive rules were under-developed and its courts were inefficient, but at the same time Russian political power structures did not implement tax or administrative countermeasures that might have reduced the incentive to use foreign legal infrastructure. Domestic legal reform was not synchronized with the demand for law; in the presence of competition from foreign legal systems, this led to jurisdictional flight for two decades, on par with capital outflows every year.

Kapeliushnikov, Kuznetsov, Demina, and Kuznetsova, *Threats to Security of Property Rights in a Transition Economy: An Empirical Perspective*, 41 JOURNAL OF COMPARATIVE ECONOMICS 245 (2012); Michael Rochlitz, *Corporate raiding and the role of the state in Russia*, 30 POST-SOVIET AFFAIRS 89 (2014).

³ The literature on regulatory competition is voluminous. For a public choice analysis of contractual choice-of-law and jurisdictional competition, see Erin O’Hara and Larry E. Ribstein, *From Politics to Efficiency in Choice of Law*, GEORGE MASON UNIVERSITY SCHOOL OF LAW WORKING PAPER, Draft of 9 December 1999, http://www.law.gmu.edu/assets/files/publications/working_papers/00-04.pdf, and Erin A. O’Hara, *Opting Out of Regulation: A Public Analysis of Contractual Choice of Law*, 53 VAND. L. REV. 1549 (2000). For sources on the European approach to regulatory competition generally, see 307 COLLECTED COURSES OF THE HAGUE ACADEMY OF INTERNATIONAL LAW 51 (2004) and the sources she cites at footnote 36.

This paper will touch on some aspects of the political economy of the Russian outsourcing. There were many players involved in this process: Russian economic actors (corporate and physical persons), their contractual and commercial counterparties abroad, Russian lawmakers, executive bodies, regulators and courts, foreign courts and arbitration venues, commercial banks, development banks, and, of course, commercial law firms as mediators of economic activity and “sellers” of legal systems that they are qualified to practice in. In the case of Russia, the Russian private economic elites were the main drivers of the outsourcing, the prime motive being asset protection and mitigation of Russian political risk. Other influential domestic actors, such as the political leadership and the large state-owned entities, did not oppose the outsourcing, reflecting a captured state but also an underlying implicit domestic consensus that Russia’s laws and legal institutions were ill-equipped to deal with the needs of large businesses.

At the other end of the equation were the suppliers of foreign law, amongst which this paper will focus on law firms and certain foreign courts. Foreign law firms were very successful in Russia, having moved into a vacuum of domestic law firms in the early post-Soviet period. The role of foreign courts, and in particular the English courts, was determined by the position of London as an international business center where many Russians maintained a presence and also the manner in which EU and English civil and commercial jurisdictional rules extended to disputes between foreign litigants with limited nexus to the forum.

The first part of this article will seek to measure the Russian outsourcing to the extent that this is possible using publicly available data. In the second part I propose a panorama of the most relevant sectors of Russian law; the purpose will be to illustrate how Russian statutory law did not, at any time, seriously limit or constrain legal outsourcing. Part III will examine the role of two categories of providers of foreign law: the foreign law firms active in Russia and the English courts, the latter being the courts outside Russia that have received the largest volume of Russian (or FSU⁴)

⁴ “FSU” stands for “former Soviet Union.” This acronym is used in this paper purely as a territorial designation (minus the Baltic countries). “CIS” (Commonwealth of Independent States) can also be used, but it is a dwindling organization (Georgia exited in 2008; at the time of writing (March 2014) the interim Ukrainian government was apparently pulling out as well). An explanation of the term “post-Soviet” that is used in the title of this article may also be in order. This terminology is used here to designate the entire period between 1992 and 2013. The underlying idea is that throughout this twenty year period and to this day, the Russian legal system has been undergoing a process of fundamental overhaul, away from Soviet legal infrastructure that was entirely inadequate to support an open market based economy, towards a new system which is still in the making. My view is that this evolutionary process is still under way and that there is no fundamental divide in this respect between the Yeltsin period and the Putin period.

business. There were many other providers of foreign law that played a role, who will not be examined here, such as providers of incorporation and corporate secretarial services, commercial banks, and development banks. Part IV will examine the consequences of the legal outsourcing; the position defended here is that the outsourcing contributed to stagnation of the Russian domestic legal system and to the inward looking backlash that is now taking place. Part V concludes.

I. Extent of the legal outsourcing

Russian legal outsourcing occurred through the deployment of several techniques: (1) the creation and use of foreign companies, either as trading entities in which profit was accumulated or as holding companies to which ownership of Russian assets was transferred; (2) the selection by Russian companies (including state-owned) of non-Russian law as governing law for their most important contracts with clauses stipulating dispute resolution outside of Russia (at arbitration or in national courts); and (3) the conduct of important commercial claims in tort or contract in courts or arbitral venues outside of Russia.⁵

Before examining these outsourcing techniques, there is a scaling question: What was the minimum size of Russian businesses that engaged in outsourcing? Small size businesses operating on local markets were naturally less susceptible to this type of transnational planning. An important factor, however, is that the Russian economy was highly concentrated over the period that is examined, particularly in certain key sectors.⁶ In 2004, working on a sample of businesses representing 60

⁵ To use the definitional categories proposed by Jürgen Basedow, these techniques were different expressions of private ordering of transnational activity. Contractual selection of foreign law and jurisdictional designation of a foreign forum expressed direct choice of law. The creation and use of foreign companies was an indirect choice of law, through the establishment of “deliberate connections” with other legal systems that were preferred for substantive reasons, without having to sever all connections with the system of origin. *See* Basedow *supra* note 1, Chapter VII.

⁶ Sergei Guriev and Andrei Rashinsky, *Ownership concentration in Russian industry*, October 2004, http://www.cefir.ru/papers/WP45_Ownership_Concentration.pdf. On current levels of concentration in the industrial sector and the ensuing risks, see the September 2013 RUSSIAN ECONOMIC REPORT of the World Bank, at p. 30, <http://www.worldbank.org/content/dam/Worldbank/document/rer-30-eng.pdf>. *The Economist* developed an index that compares assets of billionaires to total GDP. With assets of billionaires representing approximately 20 percent of GDP, Russia is second on this list (Hong Kong is first, Malaysia 3rd, Ukraine 4th, China 19th); *Planet Plutocrat*, *THE ECONOMIST*, 15 March 2014, at 57. To the concentration of private wealth one must then add the concentration of state ownership particularly in the oil and gas sector.

percent of Russian industry, Sergei Guriev and Andrei Rashinsky determined that within the sample, thirty individuals controlled as much as 42 percent of employment and 39 percent of sales.⁷ Other segments of the economy, in particular the oil and gas sector, became even more concentrated throughout the period, the state having increased its share in the sector through a number of acquisitions or takeovers (for example, Yukos, Sibneft, and TNK-BP⁸). These markets were export oriented and therefore particularly susceptible to foreign law preference. It is because of the high concentration of the Russian economy in both private and state-owned sectors and the importance of exports that the outsourcing preferences of the elites at the top resonated throughout the legal system as a whole. Finally a word on the areas of law affected. Some areas of law simply could not be outsourced; this is the case for real estate laws, laws on subsoil and natural resources, and also employment law. Real estate transactions, however, were often structured through foreign corporations (see more on this below); likewise, subsoil use licenses were often purchased and sold through corporate transactions.

A. Use of foreign companies and trusts

How does one measure the use of foreign legal entities in the conduct of Russian business and in the Russian economy as a whole? There is no synthetic source of public data that would enable us to do this, but there are indirect indicators. One indicator is the amounts of capital outflows and outbound foreign direct investment (FDI) that were reported by various public bodies, including the Russian Central Bank. There are variations depending on the sources; however most of the data shows net capital outflows from Russia every year for the period that is examined to different destinations.⁹ There was debate over the classification of some of these outflows, between “licit” and “illicit,” but for the purposes of this paper the distinction does not seem fundamental; even sources showing licit capital outflow only (and not illicit) confirmed net outflows virtually every year.

⁷ Guriev and Rashinsky, *id.*

⁸ Rosneft (which took control of Yukos and acquired TNK-BP) and Gazprom (which acquired Sibneft) are both state-owned and controlled (with listed minority stakes). Lukoil is privately owned (with a significant stake held by management). The ownership structure of the other largest Russian oil company, Surgutneftegaz, is not publicly known (*Russian Puzzle is Hard to Crack*, FINANCIAL TIMES, 23 October 2013).

⁹ Dev Kar and Sarah Freitas, *Russia: Illicit Financial Flows and the Role of the Underground Economy*, a Global Financial Integrity report, February 2013, <http://russia.gfintegrity.org/>. See Table 4 at page 16 comparing different sources on estimates of capital flight.

Once it left Russia this capital could return and it sometimes did so, reflecting the “round-tripping” of assets that is not unique to Russia and has been observed in other emerging countries. Round-tripping is a classic manifestation of legal outsourcing. An example was when a Russian individual or company contributed monetary funds to the share capital of a limited liability company formed in country X (that I shall call Company X), of which she or it owned 100 percent, and these funds were subsequently returned to Russia for various purposes, for example the acquisition by Company X of assets from a Russian seller, or loans by Company X to other Russian companies, or for a contribution by Company X to share capital of a Russian affiliate. In all of these cases the funds returned to Russia but Company X itself and all of the subsequent financial flows were governed by foreign law.

A variation on this structure would occur when the Russian individual or corporation transferred not monetary funds but shares in a Russian company directly to Company X in the form of a share capital contribution. This classic round-tripping structure was not illegal in Russia in the last two decades. The tax laws did not require recognition of any gain so the operation was tax neutral. The absence of any tax cost or violation of laws (despite the achievement of often significant preferential tax treatment) explains why the structure was used so widely. It allowed international lenders, accountants, and law firms to actively participate in the implementation of these structures without violating their own rules of professional practice.

The main purposes of round-tripping were to place assets under foreign ownership and corporate laws in order to increase overall asset protection, avoid Russian jurisdiction, engage in tax minimization, and if possible achieve anonymity.¹⁰

¹⁰ Some economists have correlated round-tripping with the laundering of proceeds of corruption. S. Ledyeva, P. Karhunen and J. Whalley, *Offshore jurisdictions (including Cyprus), corruption money laundering and Russian round-trip investment*, NBER WORKING PAPER 19019 (2013). Corrupt activities were the first to use the corporate and tax secrecy offered by certain jurisdictions; but Cyprus on its own, i.e., without additional tiers of companies being interposed (e.g., in the Caribbean), was not one of these jurisdictions, as it did not provide anonymity. In point of fact, Russian legal outsourcing was much wider than the laundering of corruption and included entire segments of legitimate business activity.

What were the main destination countries of this capital outflow? The total amounts of outbound and inbound FDI stocks from Russia's leading investment partners is set out in Table 1 below.¹¹ As is well known, Cyprus was a prime destination and in return Cyprus remains to this day the largest foreign investor into Russia, reflecting significant "round-tripping." According to the Russian Central Bank, at the end of 2012 the total stock of recorded FDI by Russian residents into Cyprus was \$152 billion, and

Table 1
Foreign Direct Investment Stocks

<i>Country</i>	<i>Outbound FDI (Russia to Country) US\$ billions</i>	<i>Inbound FDI (Country to Russia) US\$ billions</i>
Cyprus	152	150
Netherlands	65	60
British Virgin Islands	47	49
Switzerland	12	6
Luxembourg	9	30
Bermuda	2	31
Bahamas	6	29
Germany	9	21

Source: Central Bank of Russia, www.cbr.ru, figures as of 31 December 2012. The figures in the table are rounded to the closest billion. FDI includes both equity and debt.

recorded FDI by Cypriot residents into Russia was \$150 billion (representing 37 and 30 percent respectively of total reported outbound and inbound FDI stocks). The Netherlands came in a distant second, with Russia-to-Netherlands FDI at \$65 billion and Netherlands-to-Russia FDI at \$60 billion. The British Virgin Islands (BVI) were third, with Russia-to-BVI FDI at \$47 billion and BVI-to-Russia FDI at \$49 billion.

These figures reveal a number of important facts. First, the most significant FDI stocks in and out of Russia that were recorded were with jurisdictions that specialize in incorporation services. As a point of comparison, the largest FDI figures with a "normal" jurisdiction (i.e., a jurisdiction not specializing in incorporation services) were with Germany

¹¹ www.cbr.ru/eng/statistics. All figures are as of 31 December 2012 and have been rounded to the closest billion. Regarding capital movements after the 2013 Cyprus bail out crisis, see Kalman Kalotay, *The 2013 Cyprus Bailout and the Russian Foreign Direct Investment Platform* (May 24, 2013), BALTIC RIM ECONOMIES – BIMONTHLY ECONOMIC REVIEW, № 3/2013, at 58-59.

and they were much smaller. At the end of 2012, German FDI into Russia was US\$21.5 billion and Russian FDI into Germany was US\$9 billion.

Second, in terms of outbound FDI (i.e., capital leaving Russia), the prime jurisdictions all had tax treaties with Russia (with one important exception admittedly, the BVI). In terms of FDI coming into Russia, the presence of a tax treaty seemed less central, as is demonstrated by the “good” performance of the BVI, Bermuda, and the Bahamas—a logical inference being that Russian beneficial owners did not intend to route “passive” flows into these companies out of Russia (interest, dividends, or royalties) and intended to use them as passive holding vehicles for asset protection only, or possibly for trade in goods which is not as treaty-sensitive. Bermuda and the Bahamas had stocks of inbound FDI which were much lower than the outbound stocks, which seems to indicate that the proceeds of activities were directly accumulated outside of Russia (i.e., they never entered Russia in the first place).

Third, depending on the jurisdiction, FDI inflow figures into Russia did not reflect only round-tripping; many foreign (third country) investors into Russia used Cypriot, Dutch, or Luxembourg companies as vehicles through which to route their Russian investment, i.e., they too “opted out” of Russian jurisdiction. Foreign investors from a third country might be more reluctant to use the BVI, Bahamas, or Bermuda as a platform for their Russian investments, in the absence of tax treaties, so for these offshore jurisdictions it is likely that much of the investment stock into Russia was beneficially owned by Russians.

Lastly, these figures illustrate the very significant use that was made of foreign companies generally for investment in and out of Russia, reflecting a general preference by all parties, Russian and foreign, to place their investments under ownership and corporate laws that were not Russian. The use of foreign or offshore holding companies at the top of the ownership structure of major Russian companies was dominant in practice, though not always publicly disclosed.

Tables 2 and 3 set out two illustrations of such ownership structures, Alfa Group and Rusal, using information publicly disclosed in their annual accounts and IPO prospectus. The ultimate individual beneficial owners were all Russian; however, the companies at the top of these groups were incorporated in Gibraltar, Cyprus, Luxembourg, the Netherlands, Jersey, Bermuda, the Bahamas, and the BVI. Alisher Usmanov, according to *Forbes* the richest Russian individual in 2013 and the owner of large stakes in metallurgy (Metalloinvest), telephony (Megafon), the internet (Mail.ru), and newspapers (Kommersant), now owns most of his interests through a

BVI company called USM Holdings Limited.¹² Before its sale to Gazprom in 2005, Roman Abramovich held his ownership of Sibneft through five Cypriot companies called White Pearl Investments Ltd, Heflinham Holdings Ltd, N.P. Gemini Holdings Ltd, Marthacello Co Ltd and Kindselia Holdings Ltd. The *Yugraneft* decisions of the London High Court list the many other asset holding companies used by Abramovich including English registered Millhouse Capital Limited.¹³ Ivan Zyuzin, controlling shareholder of metals company Mechel, owns his shares through three Cypriot companies, Calridge Limited, Bellasis Holdings Limited, and Armolink Limited.¹⁴ There are numerous other examples. In front of virtually every Russian oligarch stands a number of property and corporate structures in Cyprus, BVI, or other similar locations.

The existence of these structures is central to the proper understanding of corporate governance difficulties during the period 1992-2013 over and beyond the content of Russian corporate law itself. The fact that the insertion of these vehicles into ownership chains was not regulated under Russian law and delivered significant corporate and tax benefits to the individuals at the top was a central feature of the Russian legal system. With a few exceptions perhaps, the main productive entities in these groups of companies are still to this day situated in Russia (and sometimes in Ukraine too). The registration of the upper tier entities in specialized jurisdictions was a manifestation of legal outsourcing for asset protection rather than the result of operational or management needs of groups of companies that were not (or not yet) truly global.

¹² *Russian Billionaire Usmanov Links Fortune to Partnership*, BLOOMBERG, 7 February 2013. Generally, the personal wealth statistics that I use in this paper are based on Forbes. This may be an imperfect source but it is the only one available to my knowledge.

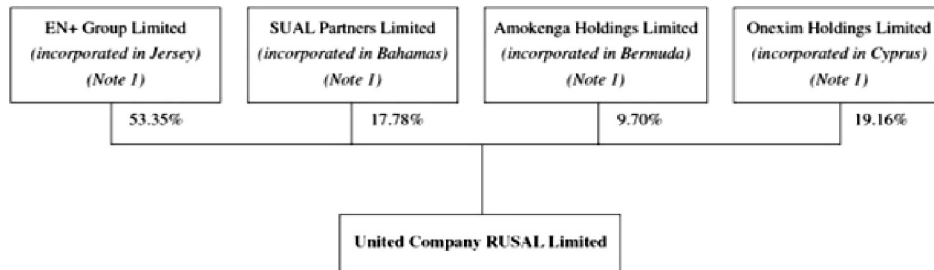
¹³ *OJSC Yugraneft v Abramovich, Millhouse and Berezovsky (Rev 1)* [2008] EWHC 2613 (29 October 2008), available on www.bailii.org, see ¶12 and Appendix 3 (list of alleged offshore structures presented by the other side). There are two *Yugraneft* decisions on the same day, numbered 2613 and 2614. Subsequent indications are that Millhouse Capital was restructured and some of its activities were moved to a Russian registered company, see *What does Roman Abramovich own?*, NOVAYA GAZETA, 17 February 2011, (<http://en.novayagazeta.ru/politics/8775.html>).

¹⁴ A small share is also routed through a Russian LLC, MetHol OOO. See SEC Form SC 13D/A, filed 29 November 2013, available at <http://secfilings.nyse.com/files.php?symbol=mtl>

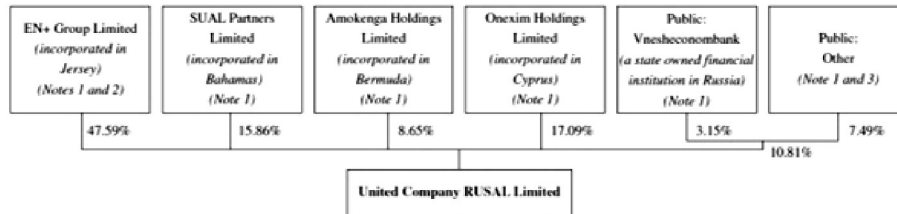
Table 2
Rusal Corporate Ownership¹⁵

Shareholding structure

The following chart illustrates the Group's shareholding structure as of the date of this prospectus:

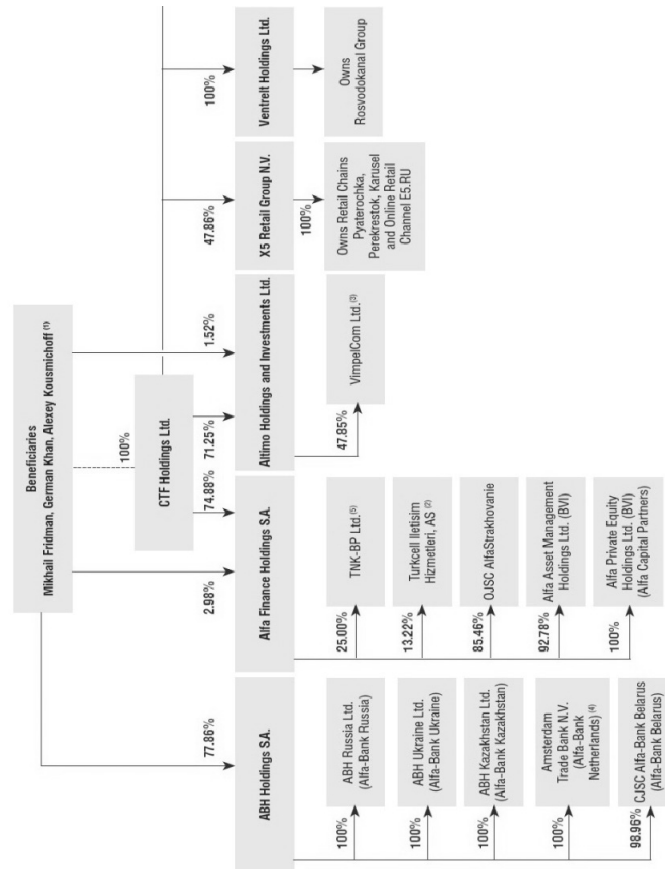


The following chart sets out the shareholding structure of the Group immediately following completion of the Global Offering, assuming the Over-allotment Option is not exercised.



¹⁵ Rusal Hong Kong IPO Prospectus (2009), <http://www.rusal.ru/upload/uf/573/PROSPECTUS.pdf>, at 89-91. At the time of the IPO, United Company Rusal Limited was registered in Jersey with main place of business in Nicosia, Cyprus (see Prospectus p. 69).

Table 3
Alfa Group Corporate Ownership¹⁶



¹⁶ ALFA GROUP 2012 ANNUAL REPORT, http://www.alfagroup.org/ENGLGO_2012.pdf. According to Alfa Group’s 2012 Annual Report, this structure “represents the high-level, effective ownership and operational structure of [the group’s] subholdings” and “[...] “it does not depict the actual and complete legal structure of [the] sub-holdings.”

Table 4
Place of Registration of Alfa Group Holding Companies

Name of company	Country of incorporation or registration
CTF Holdings Limited	Gibraltar
ABH Holdings S.A.	Luxembourg (previously registered in the BVI)
ABH Russia Ltd.	Cyprus
ABH Ukraine Ltd.	Cyprus
ABH Kazakhstan Ltd.	Cyprus
Amsterdam Trade Bank N.V.	Netherlands
CJSC Alfa-Bank Belarus	Belarus
Alfa Finance Holding S.A.	Luxembourg
TNK-BP Ltd.	BVI
Turkcell İletişim Hizmetleri A.S.	Turkey
OJSC Alfastrakhovanie	Russia
Alfa Asset Management Holdings Ltd (BVI)	BVI
Alfa Private Equity Holdings Ltd (BVI)	BVI
Altimo Holdings and Investments Ltd.	BVI
Vimpelcom Ltd.	Bermuda
X5 Retail Group N.V.	Netherlands
Ventrelt Holdings Ltd.	BVI
A Common Holdings Ltd.	BVI

Source: author's research based on public sources.

On the subject of transparency, it is worth making a separate note on the use of trusts. Jurisdictions such as the BVI, Bermuda, and the Bahamas are already characterized by strict corporate confidentiality. Neither the shareholders nor the directors of companies registered in these jurisdictions are publicly disclosed, the only public information being the name and address of the “registered agents” whose role is to render company secretarial services and provide a legal address.¹⁷ These corporate structures were therefore advantageous to shareholders or investors wishing to achieve anonymity.

¹⁷ Cyprus (like other EU countries) does not practice corporate secrecy, i.e., the names and addresses of shareholders and directors are public information that is maintained by the Cyprus registrar of companies and publicly accessible. See http://www.mcit.gov.cy/mcit/drcor/drcor.nsf/index_en/index_en#.

In addition to corporate anonymity, these jurisdictions offered a range of international trust-based instruments that were specifically designed to protect property from creditors, i.e., business partners, foreign law enforcement authorities, or even family members wishing to assert inheritance laws. When such trusts were used, the ownership of the shares of the BVI, Bermuda, or Bahamas holding companies (which are recorded as FDI investors in Russia by the CBR) did not belong to the Russian individual or settlor, but rather to a local professional trustee (usually affiliated with the registered agent) acting in accordance with a trust deed entered into with the Russian settlor. These deeds were often drawn up in such manner that it was difficult to identify the beneficiaries; in fact, many of these jurisdictions allow the concept of “non-person” purpose trusts in which property is placed without any designated human beneficiary.

It is evident that such structures raised a number of issues regarding the governance of the underlying Russian companies at the bottom of the ownership chain and the resulting concentration of the Russian economy at large. There are no statistics available on the use of these structures by Russian individuals, but anecdotal evidence seems to indicate that it was, in fact, widespread.¹⁸ One consequence was that when trusts were at the top of share ownership chains, the Russian anti-monopoly regulator was unable to independently determine the ultimate beneficial ownership of the Russian companies at the bottom. There is little doubt that this ability to remain anonymous contributed significantly to the Russian economy becoming so concentrated so fast.

B. Contractual choice of foreign law and foreign forum selection in contract or tort

In the last ten years the international press was full of disputes concerning major Russian companies. As is now well known, these disputes were usually heard not in the Russian courts but abroad. The London courts

¹⁸ A famous case in international trust law, *Schmidt v Rosewood Trust Ltd* [2003] UKPC 26, was about shareholding interests in Lukoil and affiliates that were placed in trust by one of the Lukoil directors (the director then died and his son tried to recoup some of the trust assets); see also *Berezovsky v Abramovich* (*infra* note 20), at ¶¶418, 463, 501, or in the interim award under the Energy Charter Treaty in the Yukos case, *Hulley Enterprises Limited (Cyprus) v. The Russian Federation*, PCA Case No. AA 226, UNCITRAL (Energy Charter Treaty), Interim Award on Jurisdiction and Admissibility, the numerous paragraphs regarding the “Auriga” and other trusts set up by the shareholders of Yukos (http://www.encharter.org/fileadmin/user_upload/document/Hulley_interim_award.pdf); see also Olga Boltenko, *Trusts for Russians*, May 2009, <http://www.step.org/trusts-russians>, or Vladimir Kanashevskiy, *O prave primenimom k offshornim trastam i ob ikh priznanyi*, ZAKON, No. 4/2013, at 63-67.

and London arbitration were the preferred venues, probably followed by Stockholm arbitration. Prominent examples are *Cherney v Deripaska*¹⁹ (London), *Berezovsky v Abramovich*²⁰ (London), the TNK-BP dispute between BP plc and AAR, a consortium of Russian businessmen, regarding Russian oil company TNK-BP (London and Stockholm),²¹ the Gazprom-Naftogaz dispute (Stockholm),²² the dispute between Rusal and Interros regarding Norilsk Nickel (London),²³ and there are many other examples.

In 2012, the English professional press wrote that 60 percent of the work of the London Commercial Court (a division of the High Court) was “thought to involve Russian or other Eastern European parties, even though these disputes and the parties involved often have no connection with England.”²⁴ In 2009 and 2010, the London Court of International Arbitration (LCIA) reported that amongst the countries of origin of parties having referred cases to it for arbitration or mediation, Russia came in second after the U.K. In 2009, the number of LCIA referring parties from Russia was almost the same as from the U.K. representing 11.5 percent of total referrals (versus 13 percent for the U.K.), far ahead of other countries.²⁵ Reports by the Arbitration Institute of the Stockholm Chamber

¹⁹ *Cherney v Deripaska* [2008] EWHC 1530 (Comm) (3 July 2008).

²⁰ *Berezovsky v Abramovich* (Rev 1) [2012] EWHC 2463 (Comm) (31 August 2012). Both the full judgment and an executive summary were available at <http://www.bailii.org> at the time of writing.

²¹ *BP Paying \$325M to End TNK-BP Dispute*, THE MOSCOW TIMES, 14 November 2012.

²² *Gazprom to sue Naftogaz Ukrainy with international arbitration court*, Gazprom press release, 3 January 2009, <http://www.gazprom.com/press/news/2009/january/article67860/>.

²³ *Russian oligarchs settle \$1.4bn dispute, avoid legal battle in London*, RT, 4 December 2012.

²⁴ *Magnates for law: oligarchs in London*, THE LAW SOCIETY GAZETTE, 13 September 2012; *Oligarchs pick London to do Battle*, FINANCIAL TIMES, 17 February 2012; *Top London law firms profit from feuding Russian oligarchs*, THE GUARDIAN 3 October 2012; *No end in sight to London courtrooms' oligarch litigation boom*, FINANCIAL TIMES, 1 October 2013; *Oligarchs at War in the British Courts*, THE TELEGRAPH, 17 November 2013. According to the “Unlocking Disputes” website (a promotional website), more than four cases in the Commercial Court out of five involve a non-U.K. party and in approximately half of the cases heard by the Court all of the parties are non-U.K. (<http://www.unlockingdisputes.co.uk/the-courts/the-commercial-and-admiralty-courts>).

²⁵ http://www.lcia.org/LCIA/Casework_Report.aspx. A significant number of cases was referred by Cypriot or BVI entities, possibly also including a Russian element. The proportion of Russian referrals declined a bit in 2011 and 2012, but during these years the share of Cypriot and BVI sourced referrals remained stable.

of Commerce indicate the same: In all years for which statistics were presented (i.e., since 2008), Russian parties were the most frequent foreign (non-Swedish) users of the institute.²⁶ It is true that some of these disputes were between Russian businesses and foreign counterparties; in such cases, the use of non-Russian law and dispute resolution was not unusual and did not set Russia apart from other countries.

The peculiarity, however, is that a significant portion of these international disputes was in fact disputes between Russian (or other FSU) parties, acting directly or through their foreign registered affiliates. This was the case for some of the largest cases: *Berezovsky v Abramovich*, *Cherney v Derispaska*, *Yugraneft*,²⁷ *VTB v Nutritek*,²⁸ or *AK Investments*,²⁹ to name a few. Many of these cases concerned assets or companies of national significance in former Soviet countries. *Berezovsky v Abramovich* and *Cherney v Derispaska* were about ownership of Sibneft (now Gazpromneft) and Rusal (the world's largest producer of aluminum). The Fiona Trust proceedings were about large scale corporate fraud by Russian management at Sovcomflot, Russia's largest (state-owned) shipping company.³⁰ *AK Investments* was a dispute between Russian investors regarding the main telephony operator in Kyrgyzstan. *Ferrexpo* was a dispute between Russian and Ukrainian individuals regarding the largest iron ore mine in Ukraine.³¹ *Pacific Investments* was about the ownership of the Dynamo Kiev football club.³² In March 2013 a case was filed in London by Ukrainian Victor Pinchuk against compatriots Gennadiy Bogolyubov and Igor Kolomoisky regarding another large Ukrainian iron ore mine, the Krivorozhskiy mine.³³ These were all, and still are, high profile cases representing large domestic assets. They can arguably all be viewed in the

²⁶ <http://www.sccinstitute.com/hem-3/statistik-2.aspx>.

²⁷ OJSC Yugraneft v Abramovich, Millhouse and Berezovsky (Rev 1), [2008] EWHC 2613 (29 October 2008).

²⁸ VTB Capital plc v Nutritek International Corp, Marshall Capital Holdings Ltd, Marshall Capital LLC and Konstantin Malofeev, [2012] EWCA Civ 808.

²⁹ AK Investment CJSC v Kyrgyz Mobil Tel Ltd & Ors (Isle of Man) (Rev 1) [2011] UKPC 7 (10 March 2011).

³⁰ Fiona Trust & Holding Corporation Ors v Privalov Ors, [2010] EWHC 3199 (Comm) (10 December 2010). This is the last decision in a series of many.

³¹ Ferrexpo AG v Gilson Investments Ltd & Ors, [2012] EWHC 721 (Comm) (03 April 2012).

³² Pacific International Sports Clubs Ltd v Soccer Marketing International Ltd & Ors [2009] EWHC 1839 (Ch).

³³ For a summary of the claim filed by Victor Pinchuk, see <http://claimpinchuk.eastonegroup.com/ATT97849.pdf>.

respective country as domestic disputes with very little nexus to England. Specific aspects of some of these cases will be discussed below in Part III.

What types of activities were most susceptible to the Russian preference for foreign law? Export and import activities were particularly affected, unsurprisingly. Under Russian law purely domestic transactions concluded between Russian legal entities had to be placed under Russian law, but for exports and imports the dominant practice was to place these transactions under non-Russian law. In the last decade or so the overall proportion of exports of goods and services to Russian GDP was between 25 percent and 35 percent, depending on the year. Exports were dominated by the oil and gas sector³⁴. Much of these oil and gas exports were placed under foreign law governed contracts, sometimes with “genuine” third party trading companies, sometimes with specially constituted foreign affiliates.³⁵ In 2012, 98 percent of Rosneft’s crude oil sales were export sales.³⁶ Gazprom’s natural gas export sales, in particular to its European offtakers, are still far greater than its sales to the Russian domestic market and are essential to its economics.³⁷ Just these two companies represent a remarkably high proportion of total Russian exports.

³⁴ <http://www.tradingeconomics.com/russia/exports-of-goods-and-services-percent-of-gdp-wb-data.html>, last accessed in June 2014. For Russian source trade statistics see <http://www.cbr.ru/eng/statistics/>, according to which in 2012, exports of crude oil, oil products, natural gas and LNG represented \$352 billion, i.e. 67% of total exports of goods (\$527 billion).

³⁵ At one point Rosneft had numerous trading entities in Jersey, named “R Trade 2 Limited”, “R Trade 3 Limited,” etc. (see *Yukos Capital S.a.r.l v OJSC Rosneft Oil Company & Ors*, [2010] EWHC 784 (Comm) (16 April 2010)). In the nineties, Sibneft (now Gazpromneft) used several trading companies called “Runicom” in Switzerland and Gibraltar, see Mihir A. Desai and Alexander I.J. Dyck and Luigi Zingales, *Theft and Taxes* (October 2005), ECGI - FINANCE RESEARCH PAPER No. 63/2005; EFA 2005 Moscow Meetings, Forthcoming; CRSP WORKING PAPER No. 600, available at SSRN, at 24 and footnote 14). See also *Berezovsky v Abramovich*, full judgment, which illustrates the manner in which trading companies were used in the business of Sibneft, *supra* note 20, at ¶¶175, 188, 347-352.³⁶ Rosneft Oil Company Consolidated Financial Statements 2012, at 29, http://www.rosneft.com/attach/0/02/90/Rosneft_FS_2012_ENG.pdf.

³⁶ Rosneft Oil Company Consolidated Financial Statements 2012, at 29, http://www.rosneft.com/attach/0/02/90/Rosneft_FS_2012_ENG.pdf.

³⁷ In 2012, Gazprom’s export sales were 1.8 trillion Russian rubles (circa \$60 billion), versus 900 billion Russian rubles for domestic sales (circa \$30 billion). Export sales were therefore twice the amount of domestic sales. Source: GAZPROM 2012 FINANCIAL REPORT, at 56, <http://www.gazprom.com/f/posts/01/207595/gazprom-financial-report-2012-en.pdf>.

International bank lending into the region, which has been run out of London in the last two decades, is another area in which foreign law and foreign jurisdiction dominate (in fact, English law and jurisdiction). In 2013 the EBRD reported having invested 22 billion U.S. dollars into Russia over twenty years and announced that it was the biggest foreign investor into Russia outside of the oil and gas sector.³⁸ Experience shows that the EBRD uses English law almost exclusively for its primary contractual documentation; local law is used only for security instruments which would require local enforcement (e.g., share pledges, bank account attachments, and mortgage agreements). The same applies to inward lending by the International Finance Corporation (“IFC”), the other main international financial institution active in Russia, as well as most other global banks, most of whom ran their FSU lending activities out of London using loan documentation governed by English law and based on the standard of the London based Loan Market Association (LMA). Even the large state-owned Russian banks have bases in London (and sometimes Cyprus) out of which they loan funds to Russian projects under English law: VTB, Russia’s second largest bank, owned 60.9 percent by the Russian state, is one example.³⁹

English law is completely dominant in merger and acquisition transactions as well as the choice of exchanges to list shares of Russian businesses. The London Stock Exchange holds the dominant share: 64 out of 116 Russian listings reviewed by PricewaterhouseCoopers between 2005 and August 2013 took place in London. The same source reports that amongst the issuers, 46 were incorporated outside of Russia.⁴⁰ Among the first Russian majors to list abroad were Vimpelcom and Lukoil; the former

³⁸ *The EBRD is fully committed to Russia and the CIS*, speech by S. Chakrabarti, 13 September 2013, <http://www.ebrd.com/pages/news/speeches/chakrabarti-130924.shtml>.

³⁹

http://www.vtb.com/upload/iblock/edb/Shareholder_Structure_as_of_30_June_2013.pdf. For an example of VTB lending out of London, see *VTB Capital Plc v Nutritek International Corp & Ors* [2011] EWHC 3107 (Ch) (29 November 2011), *VTB Capital plc v Nutritek International Corp, Marshall Capital Holdings Ltd, Marshall Capital LLC and Konstantin Malofeev* [2012] EWCA Civ 808 and *VTB Capital Plc v Nutritek International Corp & Ors (Rev 1)* [2013] UKSC 5 (6 February 2013). For an example of VTB lending from its base in Cyprus, see *Russian Commercial Bank (Cyprus) Ltd v Khoroshilov*, [2011] EWHC 1721 (Comm) (05 July 2011).

⁴⁰ *An overview of Russian IPOs from 2005 to 2013: Listing centers, investment banks, legal counsels, auditors, and issuers’ jurisdictions*, PWC, <http://www.pwc.ru/en/capital-markets/russian-ipo.jhtml> (2013).

in New York in 1996, the latter in London in 1997.⁴¹ The largest Russian primary listings were by state-controlled Rosneft and VTB Bank who raised \$10 billion and \$8 billion (respectively) in both London and Moscow.⁴²

This is but a rapid panorama of indirect indicators of the extent of Russian legal outsourcing. Even without delving further into the statistics it is clear that wide segments of the Russian economy were affected.

II. Russia's non-competitive laws

One must now look at Russian laws to see how it was technically possible to have so much outsourcing. In a globalized world with regulatory competition between countries, countries can limit the ability of citizens and corporations to move out their activities or use foreign law through laws constitutive of *ordre public* or mandatory overriding provisions, in the areas of tax, private international law, and administrative law (capital controls, anti-monopoly laws, and regulations on foreign investment). Countries can also compete by ensuring that their domestic laws, in particular their contract law and corporate law, are sufficiently well developed. In Russia, what occurred over a period of 20 years was a system that opened up completely in terms of tax and administrative law, but failed to adopt sufficiently developed contract law and corporate law (let alone to improve the work of its courts and law enforcement bodies). Tax being the most powerful tool that the Russian authorities did not deploy in any meaningful manner, I propose to start with that. The other sectors will then be reviewed in turn. I will also say a word on the political risk element.

A. Tax law

The use of holding and trading companies in low tax jurisdictions is a classic tax minimization scheme. Governments seeking to protect revenue in open economies can respond by (1) not signing tax treaties with these jurisdictions, (2) signing treaties but only with robust anti-avoidance provisions, and (3) introducing domestic anti-avoidance rules. In the last two decades the Russian authorities made three major policy decisions as a result of which the tax laws failed to curb the use of foreign companies. First, they implemented a domestic tax regime that was altogether unattractive for domestic holding companies: For many years Russia did not exempt capital gains from sales of shares (i.e., treated them like

⁴¹ Vimpelcom press release of 15 November 1999, at <http://www.vimpelcom.com/Media-center/Press-releases/1999/VimpelCom-marks-third-anniversary-of-NYSE-listing-amidst-record-subscriber-growth/>; Lukoil press release of 29 April 1997, at http://www.lukoil.com/press.asp?div_id=1&id=282&year=1997.

⁴² Excluding Sberbank's rights offering, which was larger but in Moscow only.

ordinary business income), nor did it exempt dividends. This meant that it was tax inefficient to interpose a Russian holding company between a top Russian shareholder and Russian operating subsidiaries located beneath in a group structure, although such holding structures would have offered clear corporate governance advantages.⁴³

Second, at the demise of the Soviet Union in December 1991, the Russian government acceded to all the Soviet tax treaties. When it did so, Russia immediately inherited a full set of treaties with jurisdictions offering low tax regimes: Cyprus, the Netherlands, Switzerland, Luxembourg, Austria, to name but a few, often without any withholding taxes at all.

This was already a perfect storm; Russian domestic tax law, just emerging from its Soviet depths, was struggling to adapt to the new market realities. Soviet capital and exchange controls had been removed and overnight Russian businessmen found themselves at the center of an immediately available treaty network with very appealing countries—all without even having to break any laws. Other post-Soviet states such as Kazakhstan or Georgia did not accede to the Soviet tax treaties, or did so selectively, so economic agents in those countries found it (somewhat) more complicated to transfer valuable assets to holding companies abroad.⁴⁴

Russia's third major policy decision was not to implement any serious domestic anti-avoidance provisions, such as robust transfer pricing rules or CFC (controlled foreign corporation) type provisions imputing foreign income to Russian taxpayers when that income is received by a low-tax foreign company under their control.⁴⁵ CFC rules were deployed in several

⁴³ Participation exemption was introduced in Russia only in 2008. Sergey Chelishkov, *New Russian "Participation Exemption" Rules for 2008*, THE MOSCOW TIMES, 22 May 2007.

⁴⁴ Delphine Nougayrède, *A Critical Review of Georgian Oil and Gas Tax Legislation*, TAX NOTES INTERNATIONAL, 3 September 2001, at 1225, footnote 4, available at SSRN. Like Russia, Ukraine acceded to the Soviet treaties upon independence in 1991.

⁴⁵ To summarize, CFC rules effectively impute foreign income earned through tax haven companies to their domestic beneficial owners. Victor Thuronyi, *COMPARATIVE TAX LAW*, 2003, at 296-298. On comparative CFC regimes, see DELOITTE, *GUIDE TO CONTROLLED FOREIGN COMPANY REGIMES* 69-71 (2014), available online at <http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-guide-to-cfc-regimes-210214.pdf>, with a list of countries that do not have such legislation (including Russia and Ukraine). *Id.*, at 70. A second important set of anti-avoidance rules are transfer pricing provisions, which aim to control transactions between related parties. In the case of Russia, robust transfer pricing rules were not introduced until 2012.

of the former Soviet states,⁴⁶ but not in Russia (or, for that matter, in Ukraine). Transfer pricing was introduced (Article 40 of the Russian Federation Tax Code), but it was subject to abuse.

There does not seem to be any clear reason for the failure to introduce robust anti-avoidance rules.⁴⁷ The debate took place all throughout the second half of the nineties when lawmakers were debating the new tax code that was passed under the late Yeltsin and early Putin years (1998 to 2000), and then again in subsequent years, but it can be assumed that already in the mid-nineties interest groups in the private sector and government were working against anti-avoidance generally. At the time foreign advisory agencies such as the International Monetary Fund were actively advocating the introduction of robust tax enforcement measures, including transfer pricing and CFC, but there was resistance on the part of liberal groups within the Duma, in particular the Yabloko party under Grigory Yavlinsky, then well represented on the Duma tax committee; this group defended civil liberties and wanted to avoid giving Russian state authorities too many powers that might be abused.⁴⁸ The convergence of views between captured lawmakers and rights advocates (each for radically different reasons) meant that the use of foreign companies in low tax jurisdictions was allowed to flourish.

B. Private international law

Once in place, foreign corporate affiliates opened avenues of possibility in terms of contractual choice of law, both for the internal activities of Russian groups and for their dealings with third parties. The relevant provisions are in the third part of the Civil Code, which was adopted in 2001.⁴⁹ In brief, to this day Russian law recognizes the legal status of foreign

⁴⁶ Kazakhstan introduced CFC rules in 1995. See Richard Bregonje, Sergey Bezborodov, *The Battle against Tax Haven Rages on in Kazakhstan, Tax Treaty Partners Being Victimized*, ARGUS MEDIA BEOBACHTEN, 1995, at http://www.pwc.ch/user_content/editor/files/articles10/pwc_20100329_intertax_bezborodov.pdf. Georgia introduced CFC rules in 1997 (Article 66 of the 1997 Tax Code).

⁴⁷ Robust transfer pricing legislation was introduced in 2012. CFC rules still have not been introduced at all, although in his annual address of 12 December 2013 Putin announced that CFC type rules would be introduced as part of his general “de-offshoring” policy. <http://eng.kremlin.ru/transcripts/6402>, accessed on 7 January 2014.

⁴⁸ DELPHINE NOUGAYRÈDE, *CONSTRUIRE L’IMPÔT EN RUSSIE*, ¶¶532-3-534 (2001).

⁴⁹ Before adoption of the third part of the Civil Code, Russian private international law was set out piecemeal in several Soviet statutes, in particular the 1991 Fundamentals of Civil Legislation of the U.S.S.R. and Union Republics and

companies fully, without any limitations; it applies the “incorporation theory” rather than the “real seat theory”⁵⁰ and does not look to the place of actual management of the company (Article 1202 of the Civil Code).

Likewise, Russian private international law looks favorably on party autonomy for choice of law: For most contracts, foreign law can be selected when there is a sufficient “foreign element,” which is usually considered to be the case when one of the contracting parties (for example, an offshore affiliate) is foreign. Party autonomy cannot displace imperative norms of Russian law (Articles 1210 and 1192 of the Civil Code) nor can it “manifestly contradict the bases of the public order of the Russian Federation” (Article 1193), but these provisions were not, at least until now, deployed to challenge widespread use of foreign affiliates and foreign law selection in commercial transactions. This sanguine approach to private international law is, indeed, consistent with the majority of developed countries.

Of course, there were certain types of contracts for which Russian law always had to be used, if only because they were subject to state registration or notarization; for example property contracts (for the sale of buildings or mortgage agreements) and from 2009 sales of shares in Russian limited liability companies. However, practice showed that even in these cases if there was a foreign party it was usually possible to place the main commercial terms in a separate foreign contract governed by non-Russian law, with Russian law being limited to a short form side document only purporting to effect the transfer of title itself.⁵¹

As regards property transactions, moreover, for many years the dominant practice was first to place the property in a foreign holding company (for example, Cyprus) and then sell the shares of the company enabling the parties to obtain tax advantages⁵² as well as place the entire sale and purchase contract under foreign law and dispute resolution. For all practical purposes, therefore, in such structures all key transactions terms

the 1964 Civil Code of the Russian Soviet Federative Socialist Republic. See Viktor P. Zedkov, *The New Civil Code of the Russian Federation and Private International Law*, 44 MCGILL L.J. 525 (1999).

⁵⁰ Basedow, *supra* note 1, at 273.

⁵¹ To be complete, it must also be said that the general practice is to place contracts governing security instruments, e.g., share pledges, mortgages, and bank account attachments, under Russian law in order to facilitate enforcement.

⁵² In recent years the tax authorities began to capture such transactions as tax evasion, however for many years the practice of selling shares in foreign companies rather than the property itself (and therefore without VAT) was tolerated.

(conditions precedent, price, price adjustments, liability for breach, etc.) ended up governed by non-Russian law.

In 2001, at the time of adopting the third part of the Civil Code, the proliferation of foreign structures did raise concerns in some circles. Discussions took place as to whether to include a specific clause on “evasion of law,” the purpose of such a clause being to deny the choice of foreign law if circumstances appeared too artificial or fraudulent. Such clauses exist in a number of countries.⁵³ Alternatively, restrictions might have been placed on party autonomy.⁵⁴ Ultimately, the position that prevailed in Russia, however, was that the existing set of rules on *ordre public* and mandatory rules would be sufficient⁵⁵.

To summarize, therefore, in terms of choice of law and recognition of foreign companies, for many years Russian private international law consistently applied the mainstream paradigms of party autonomy and incorporation theory. It never sought to introduce any restrictions that might have recognized the circumstance that its own laws were not sufficiently developed or were not considered adequate to serve the needs of significant financial interests operating in an economy that was already very open. One wonders whether the academic elites who were involved in these debates on private international law were sufficiently aware of what was actually happening in the business sector.

C. *Contracts and corporate law*

Russian contract law evolved very slowly between 1992 and 2013. The main milestones are the adoption of the two first parts of the Civil Code in 1994 and 1996,⁵⁶ then followed by very numerous amendment laws and now a recent larger scale effort to modernize the Code (on this see Part IV below). Before 1995, most of Russian civil legislation was still Soviet.⁵⁷

⁵³ Basedow, *supra* note 1, at ¶ 348, citing *inter alia* Belgium, Hungary, Portugal, Romania, Spain, Ukraine, Angola, Mozambique, and Tunisia.

⁵⁴ *Id.*, ¶¶ 187-191, citing the examples of Brazil, Uruguay, and Iran, which have (or had) restrictions on party autonomy in relation to choice of law.

⁵⁵ Olga Vorobieva, Chapter on “Russia,” in INTERNATIONAL ENCYCLOPAEDIA OF LAWS: PRIVATE INTERNATIONAL LAW (ed. B. Verschaegen, 2011) ¶¶ 132-134, 138.

⁵⁶ Federal Law No. 51-FZ, dated 30 November 1994, and Federal Law No. 14-FZ, dated 26 January 1996.

⁵⁷ *Supra* note 49. Some Russian practitioners argue that the 1994/1996 Civil Code was still infused with Soviet paternalism (Dmitry I. Stepanov, *Proekt grazhdanskogo kodeksa: ot paternalisma po-sovetsky k istinnomu chastnomu pravu*, ZAKON, 5/2012, p. 97-99).

The dominant view of businesses and their advisors throughout the period 1992-2013 was that Russian contract law was inappropriate for large transactions.

Seen in the wider historical perspective, of course, the underdevelopment of Russian contract law was inevitable. There was no such thing as socialist contract law—until very late in the perestroika years, enterprises did not even exist as separate legal persons and were endowed not with contract-based rights of any sort, but rather with administrative rights and obligations to receive supplies, use their assets and ship their products to other enterprises. Their activities were governed by webs of bureaucratic orders and regulations issued by planning bodies and the economic ministries. Managing a Soviet enterprise was, by and large, an a-legal activity which generated very little interaction with legal infrastructure. Dispute resolution was by *arbitrazh* tribunals which did not constitute courts of law; they were considered administrative dispute resolution bodies embedded into the fabric of the economic ministries. In short, in 1992 the construction of a commercial contract law had to start from scratch.

The reproaches formulated against Russian contract law are quite specific. The main concern is that it does not properly protect an innocent contracting party in the event of contractual breach by the other party. The body of evidence that must be presented in order to obtain a ruling of breach by a commercial court (still called *arbitrazhny*) is burdensome and highly document-centric. Judges are insufficiently familiar with economic realities and often skeptical of business activity generally. If a ruling of breach is obtained, the measure of damages is usually limited to direct loss only (and sometimes not even), without addressing loss of profit, loss of reputation, or other forms of indirect or intangible loss.

The Russian Civil Code does not include warranty concepts similar to those available under English law or most other continental systems that allow a purchaser (of shares, for example) to claim for loss in the event of defects in the object (or company) that has just been acquired. Nor does the Russian Civil Code clearly allow the concept of completion of a transaction being dependent on conditions precedent that may or may not be satisfied, thereby hindering the conduct of acquisition transactions that need to be structured in several phases (as is frequently the case in Russia). Finally, the use of Russian contract law was hampered by a debate on the difference between “imperative” and “dispositive” norms, this discussion revealing the extent of the lingering doubts in the minds of many Russian jurists as to the real extent of freedom of contract.⁵⁸

⁵⁸ *Svoboda dogovora i predely dispozitivnosti v grazhdanskom prave*, ZAKON, 11/2013, p. 13, regarding a draft regulation of the Supreme Arbitrazh Court on

Yet during this period the Russian need for contract law was great. The privatization programs of the mid-nineties meant that thousands of assets and companies were being bought and sold, sometimes representing very large transactions. In this context the weakness of Russian contract law was an additional justification for the use of foreign holding companies, as this form of transnational structuring enabled the migration of corporate transactions away from Russian law towards English law (or other legal systems perceived to be more sophisticated).

The situation of corporate law was similar to that of contract law because of the same Soviet heritage. The main company laws were adopted in 1996 and in 1998.⁵⁹ Numerous amendments were carried out subsequently in a piecemeal manner to this day seeking to address certain key issues of corporate governance that still remain unsettled.

Amongst these issues one of the most sensitive was how to deal with minority shareholders. In an economy where ownership had become highly concentrated this theme reflected the tension between the interests of powerful core shareholders seeking to assert their control and numerous but dispersed minority shareholders many of whom were individual employees (or their descendants) who had received shares as a result of mass privatizations (the first phase of privatization).

Another key topic was (and still is) shareholder or joint-venture agreements. Russia's economy is dominated by heavy industry and natural resource extraction that require large capital investment, hence the importance of investment pooling and joint-venture type arrangements; the Russian economic elites have long had a practice of negotiating such arrangements discretely outside of company charters, in dedicated shareholder agreements not disclosed to other shareholders. Until 2009, Russian law did not even recognize the concept of shareholder agreements, meaning that any meaningful joint-venture arrangements had to be organized under foreign law in holding companies formed outside of Russia.⁶⁰ For such shareholder and joint-venture agreements English law

freedom of contract. The regulation was issued in March 2014 (regulation No. 16 of 14 March 2014).

⁵⁹ The two laws are the Joint-Stock Company Law (Federal Law № 208-FZ of 26 December 1995) and the Limited Liability Company Law (Federal Law № 14-FZ of 8 February 1998). Foreign technical assistance was used for the first version of the laws, but the impact of this assistance has usually been overstated by Western commentators as the most important provisions of both laws were adjusted piecemeal many times over the years that followed.

⁶⁰ The seminal court decision on shareholder agreements is the Megafon decision of 2006 in which provisions of an agreement governed by Swedish law were set aside. For Western scholarship on Russian shareholder agreements see

was the dominant choice of law. The practice of building joint-venture and shareholder arrangements outside of Russia continues to this day, despite the introduction of Russian-law shareholder agreements, mainly because of the general difficulties of Russian contract law that were described above.⁶¹

To summarize, therefore, Russian contract and company law were viewed as insufficiently robust to support significant transactional activity. This was true throughout the entire 1992-2013 period and particularly during the high growth years of 2000-2008.

D. Administrative law

Absent any robust disincentives to legal outsourcing in the areas of tax law and private international law, one might have expected to find some anti-avoidance measures in some of the administrative laws: currency controls, anti-monopoly, and foreign investment control in particular. Here, however, the Russian regulatory patchwork was completely ineffective.

Currency controls did exist throughout the nineties and on their face they seemed quite harsh, but businesses learned to manage their risk by filing significant volumes of underlying documentation to justify transfers of funds in and out of Russia and in some cases even by creating licensed banking affiliates within their group structures in order to internalize the currency control functions. Eventually, currency controls became a matter of bureaucratic compliance without leading to any material change in capital outflows and attendant legal outsourcing. In 2007, the Russian ruble became convertible and currency control restrictions were virtually phased out.⁶²

Anti-monopoly regulations operated in the same vein. From the early nineties, Russia had fairly strict anti-monopoly control on paper, which required a full filing even when transferring shares of subsidiary companies within a group of companies, i.e., without any change of control. But it was largely a paper tiger, resulting in a high number of filings and significant

Karina Pulec, *Legal Restraints on the Use of Shareholders' Agreements for Structuring Foreign Investment Deals in Russia*, 45 CORNELL INT'L L.J. 487 (2012), and Suren Gomtsian, *The Enforcement of Shareholder Agreements Under English and Russian Law*, 7 JOURNAL OF COMPARATIVE LAW 115 (2012).

⁶¹ Shareholder agreements were introduced in Russian law in 2009. Amendments to Article 1214 of the Civil Code adopted on 30 September 2013 clarified that they can be placed under non-Russian law, subject however to the mandatory rules of Russian law that are set out at Article 1202.

⁶² *Currency Regulation*, Russian Law Online, <http://www.russianlawonline.com/content/russia-currency-regulation-control>.

difficulty for the regulator to properly identify those transactions which would really affect the market. There were no provisions aiming to discourage acquisitions by foreign holding companies. Formal disclosure of ownership structures was requested only up to a certain level; only in 2009 did the anti-monopoly law start requiring the disclosure of actual beneficial ownership at the very top (for beneficial owners holding more than 5 percent).⁶³

During the first decade of the 21st century, as the economy was growing and merger and acquisition activity was picking up, the political leadership started to worry about its control over foreign investment and foreign acquisitions. Absent a specific law allowing it to vet such acquisitions it had to resort to the anti-monopoly law. In 2005, for example, the anti-monopoly regulator refused to approve Siemens' proposed acquisition of a controlling stake in certain divisions of *Silovye Mashiny* ("Power Machines"), a manufacturer of turbines.⁶⁴ The consensus view at the time was that the real concern was not economic concentration, but rather the fact that a foreign group was about to gain control of an important supplier to the Russian defense sector.

In order to address what it perceived as an important loophole, the government engineered the adoption of a new law limiting foreign acquisitions in 42 designated "strategic" sectors.⁶⁵ The law banned certain foreign acquisitions altogether and for the rest created a commission panel (headed by Putin) that would give its prior approval. The point here is that this law was adopted in 2008, i.e., quite late in the game. Before 2008 there was no regulatory constraint whatsoever on the acquisition of strategic assets or companies by foreign holding companies. As a result, entire segments of Russian natural resources became owned by foreign holding companies (many of them under the control of Russian beneficial owners).

E. Political risk

To summarize, the main picture is that of a system that was both uncompetitive in important internal areas such as contracts and corporate law, but at the same wide open to foreign competition by virtue of its private international law, taxation, and administrative law. An additional

⁶³ July 2009 amendments to the Federal Law № 135-FZ "On Protection of Competition," dated July 26, 2006.

⁶⁴ *Anti-monopoly agency blocks Siemens' acquisition of Russian firm*, Pravda.ru, 13 April 2005, <http://english.pravda.ru/news/russia/13-04-2005/62234-0/>.

⁶⁵ Federal Law № 57-FZ "On the Procedure of Making Foreign Investments in Companies of Strategic Importance for National Defense and State Security" dated 29 April 2008.

feature, finally, is the political risk factor or, more precisely, the risk of discretionary deployment of the law by Russian state bodies as a weapon in pursuit of political or other extra-legal aims.

Yukos is the seminal example. There were two successive Yukos affairs, the first (that was tax driven) in 2003-2005 as a result of which state-owned OAO Rosneft took control of OAO Yuganskneftegaz, the largest production unit of Yukos, and the second in 2009-2010, which centered on further criminal condemnations of Mikhail Khodorkovsky and Platon Lebedev in connection with the same facts as those that were the basis for the first affair. Much has already been written on these affairs;⁶⁶ it does not seem necessary to add anything here other than to emphasize that the Yukos affair was hugely damaging to the perception of investment risk in Russia and therefore further fueled the legal outsourcing by Russian beneficial owners who wished to shield their assets.⁶⁷

F. Conclusion

Russian law was uncompetitive in important internal areas yet wide open to foreign competition. The Russian investment climate was impaired by political risk. All of these combined features fed the legal outsourcing. One wonders why the Russian executive and lawmakers did not try harder to introduce substantive rules of law that might have reduced the outsourcing in an orderly way. Was there an ideological preference not to intervene in business and to facilitate transnational activity or integration of Russian companies into the world economy? Was it the result of state capture in order to protect the elite's wealth abroad?

⁶⁶ See in particular CURTIS MILHAUPT AND KATHARINA PISTOR, *LAW & CAPITALISM*, Chapter 8 (2009), and Paul Stephan, *Taxation and Expropriation—The Destruction of the Yukos Oil Empire*, 35 *HOUSTON J. INT'L L.* 1, 5-27 (2013).

⁶⁷ Another characteristic of the Russian environment is the high level of corruption. The impact of corruption on legal outsourcing, however, is not completely clear. On the one hand one might think that corruption in the Russian courts incentivized Russian economic actors to prefer foreign (less corruptible) venues. Some scholars have pointed out the opposite effect however, i.e., that corruption could in fact incentivize economic actors to use the Russian courts, if they believed that they would be able to manipulate the system to their advantage (Pär Gustafsson, *The emergence of the rule of law in Russia*, in 14 *GLOBAL CRIME* 82-109 (2013), available at www.academia.edu). The use of foreign legal entities has often appeared in corrupt schemes, feeding the argument that outsourcing was a reflection of corruption (see Ledyeva, Kakhunen and Whally, *supra* note 10). To properly analyze the effect of corruption it is probably necessary to “unpack” the outsourcing, e.g., distinguishing between judicial outsourcing (use of foreign courts) and corporate outsourcing (use of foreign companies).

It is impossible to ignore that amongst the first priorities of the government and parliament was the defense of financial interests that were formed throughout the nineties, some of it their own. Much has been written on this period during which property was massively and opaquely redistributed by the state to private interests and that led to levels of economic concentration in today's Russia that are unique in the world.⁶⁸ To this day, the majority of the Russian population still denies legitimacy to these asset transfers.⁶⁹ In the mid-2000s a debate took place on whether to implement an amnesty mechanism whereby the beneficiaries of the privatizations would be required to pay compensation to the state.⁷⁰ However, nothing came out of it and business elites continued their asset protection strategies by legal outsourcing. At the end of the nineties and in the early Putin years, for very different reasons, some academic and political circles thought that it was important to keep the enforcement and repressive powers of state bodies in check in an effort to allow economic and civil activity to rebound from the depths of the systemic collapse of the

⁶⁸ There are troves of literature on Russian post-socialist transition. Selecting a few references only, within this great mass, is a scholarly exercise in itself. For sources most representative of the Western thinking that prevailed at the time, see MAXIM BOYCKO, ANDREI SCHLEIFER, ROBERT VISHNY, *PRIVATIZING RUSSIA* (1995) and ANDERS ASLUND, *BUILDING CAPITALISM* (2002). For critical views on the reforms, see LAWRENCE R. KLEIN AND MARSHALL POMER (eds) (with a preface by Joseph Stiglitz and a foreword by Mikhail Gorbachev), *THE NEW RUSSIA: TRANSITION GONE AWRY* (2001); Joseph Stiglitz, *Who Lost Russia?* (Chapter 5) in *GLOBALIZATION AND ITS DISCONTENTS* (2002); and more recently, IOANNIS GLINAVOS, *NEOLIBERALISM AND THE LAW IN POST COMMUNIST TRANSITION*, 2010. For a justification of the early advice given by foreign advisors, see Jeffrey Sachs' blog at <http://jeffsachs.org/2012/03/what-i-did-in-russia/>. Finally, for a high-level analysis by a key Russian architect of reform, see YEGOR GAIDAR, *RUSSIA: A LONG VIEW* (2012). Gaidar's view is that the post-socialist transition of the early nineties was no less a revolution than the Bolshevik Revolution of 1917 and that these revolutionary conditions explained some of the defining characteristics of the period: (i) weakness of the state and of state institutions, (ii) unprecedented challenges in defining and implementing public policies and (iii) capital flight and short term opportunistic behavior by businesses and individuals.

⁶⁹ According to a poll conducted by the respected Levada Center in October 2011, 42 percent of respondents believed that all of the privatizations of the nineties should be reversed, 33 percent believed that they should be reversed on a case by case basis in the event of illegality, and only 17 percent considered that the question should no longer be raised (<http://www.levada.ru/30-11-2011/rossiyane-ogosudarstvennoi-sobstvennosti-i-promyshlennosti>).

⁷⁰ Guriev and Rashinsky, *supra* note 6. The idea of an amnesty tax that would be as high as 75 percent or 80 percent of the price undervalue at the time assets were privatized was even proposed by Oleg Deripaska in 2004, see his article *Beating Poverty Through Equal Opportunities*, *THE MOSCOW TIMES*, 18 February 2004.

nineties. The adoption of a low flat-rate income tax (at 13 percent) can be viewed in this light. In a country where tax revenue had been falling this was a counter-intuitive move, but in fact it ended up a success with collections rebounding significantly. Liberal groups such as Yabloko in particular defended rolling back state powers generally.

In this context, it is relevant that the Russian legal outsourcing began at the very beginning of the post-Soviet period in the early nineties. This is amply illustrated by the historical accounts that appear in cases such as *Cherney v Deripaska*, *Berezovsky v Abramovich*, *Yugraneft* or even in much smaller cases like *Base Metal Trading v Shamurin*. This last case is about a metals trading joint-venture that was set up in Guernsey by several Russian individuals in 1992. The judge recounts the story as follows:

The story goes back to the collapse of the Soviet Union in 1991. Mr Shamurin and his two Russian friends, Yuri and Mikhail Zhivilo, who at all relevant times were resident and working in Moscow saw the opportunity to make money from the export of non-ferrous metal from Russia to the West. To this end they formed a number of Russian companies to invest and trade in metal. By the autumn of 1992 they were considering setting up a foreign company. The structure envisaged was that the foreign company would make short-term loans to the Russian companies to enable them to purchase metal in Russia. The metal so purchased would then be sold on to the foreign company which would take title outside Russia and sell it to western companies. This would enable the foreign company to generate profits outside Russia in hard currency and attract customers reluctant to become involved in the confused banking, legal and regulatory situation prevailing in Russia at the time. The company was therefore to be established in a stable jurisdiction with a clearly defined legal system. A company established in or associated with the U.K. was one obvious choice.⁷¹

According to this narrative, Russian businessmen set up foreign companies primarily to deal with foreign counterparties who did not wish to deal with Russian law or Russian companies at the time. This is certainly true in part, but it is not the entire truth. Businessmen wished to build relations with foreign partners, but they also wished to protect their own activities and profits by placing them in foreign companies, especially anonymous companies such as the ones offered by Guernsey at the time and on foreign bank accounts. In those early years nobody knew if the

⁷¹ *Base Metal Trading Ltd. v Shamurin* [2004] EWCA Civ 1316 (14 October 2004), ¶ 2.

economic reforms would last or if they might be reversed.⁷² Individuals who saw economic opportunities wanted to seize them immediately, not knowing what would follow. A lot of this early wealth was formed before the adoption of the first significant business laws in 1995 and 1996.⁷³

The massive use of foreign legal entities started as soon as travel restrictions were lifted and financial flows were liberalized, i.e., in 1992. Lawyers, company administrators, and other professionals in jurisdictions specializing in incorporation services welcomed these new clients whose business models seemed to generate substantial cash flows. Russian businessmen gained experience dealing with foreign nominee directors, lawyers, accountants and other professionals; they became increasingly comfortable with the operation of such vehicles which appeared very user-friendly, so they registered many more and continued to use them uninterrupted during the following two decades. They did so for all of the reasons that were set out above in this Part II and in particular the failure by Russian tax or administrative laws to effectively capture or regulate any of this transnational activity in any way.

The corporate and contractual outsourcing started in 1992 and nothing happened subsequently to convince Russian economic elites that it might be preferable or necessary to operate otherwise. For the purpose of this Part II, I therefore propose to conclude by positing that over the last two decades Russian law was both wide open to competition from foreign systems absent effective tax and administrative controls that could have restricted the use of foreign legal infrastructure, and domestically uncompetitive on substance. This situation was the result of the political and economic elite's desire for asset protection, political risk mitigation, state capture in Russian political structures, and the ideological dominance of theories promoting the roll-back of the state. It was also enabled by easy access to foreign legal infrastructure—which leads us to the next Part on the role of suppliers of foreign law.

III. The role of suppliers of foreign law

This Part will look at the role of two categories of suppliers of foreign law: the foreign law firms providing legal services to Russian economic actors and the foreign courts. There were other providers of foreign law that played a role—for example, providers of corporate secretarial services, private banks, and development banks such as the EBRD or IFC—however, they are not examined here. The absence of a pre-existing Russian legal

⁷² See Gaidar on the revolutionary conditions of 1991 and 1992, *supra* note 68.

⁷³ By this I mean the two first parts of the Civil Code and the company laws, see II.C. *supra*.

profession meant that foreign firms were able to form a dominant position very early on. As regards foreign courts, the position of London as an international business center combined with European and English jurisdictional rules enabled London to become the preferred center for the resolution of large-scale Russian and FSU commercial disputes.

A. *The foreign law firms*

In contrast to other BRICS countries,⁷⁴ the Russian market for legal services was almost completely deregulated. There were (and at the time of writing, still are) two groups of practicing lawyers in Russia: advocates (*advokaty*), who are members of the regulated bar and have a quasi-monopoly over the criminal representation of clients⁷⁵, and unregulated legal advisors (whom I propose to call *yuristy* in this article), who can render legal advice in all areas of law and also represent clients in civil or commercial proceedings. In 2013, there were approximately 67,000 registered advocates.⁷⁶ For *yuristy* there is no official count.⁷⁷ The vast majority of the corporate law firms in Moscow and Saint-Petersburg practice as *yuristy* and not as regulated advocates—one of the reasons being that the practicing constraints of advocates are difficult to reconcile with the operation of modern law firms.⁷⁸

The question whether and how to regulate the activities of *yuristy* has been a recurring theme in the Russian legal profession in the last two decades. In 1995, the Ministry of Justice implemented a licensing regime

⁷⁴ David Wilkins and Mihaela Papa, *The Rise of the Corporate Legal Elite in the BRICS: Implications for Corporate Governance*, 54 B.C. INT'L & COMP. L. REV. 1149 (2013).

⁷⁵ Paragraph 2 of Article 49 of the Russian Criminal Procedure Code allows certain individuals who are not advocates to appear as counsel at criminal trials.

⁷⁶ “Justice” Program of the Government of the Russian Federation (*Gosudarstvennaya programma Rossiskoy Federatsii “Yustitsia”*), p. 43, August 2013, <http://minjust.ru/sites/default/file...4/93011572.doc> (last accessed in March 2014).

⁷⁷ In 2008, the head of the Russian office of the U.S. NGO Pil.net gave an unofficial estimate of 430,000 *yuristy*. Dmitry Shabelnikov, *The Legal Profession in the Russian Federation*, October 2008 (<http://www.osce.org/odihr/36312>). To be quite clear, *yurist* means “lawyer,” accordingly advocates (in Russian *advokaty*) are also *yuristy*. The designation of legal advisors as *yuristy* in this paragraph is only for convenience purposes.

⁷⁸ In essence, the current rules for practicing advocates are akin to those that apply to English barristers, i.e., advocates must practice within independent chambers, cannot form limited liability legal entities, and cannot be employed under employment contracts.

whereby all law firms or individual lawyers had to receive a three year license in order to practice.⁷⁹ However, this licensing regime was phased out.⁸⁰ In 2002, at the time of the adoption of a new bar law regulating the activities of advocates,⁸¹ the activities of lawyers practicing in the unregulated sector were not captured and continued to develop without any regulatory framework.

As of early 2014, the state of play on the Moscow legal services market fundamentally reflected first entrant advantage. The best established firms, as a general rule, were those who entered first, and they were all foreign. The foreign firms came as early as 1990 or 1991 (and some even in 1988 or 1989), before the collapse of the Soviet Union, well before any Russian commercial law firm had even been formed. These firms deployed significant resources and financial means; they recruited graduates from a small group of Russian law schools in Moscow and Saint-Petersburg and invested heavily in training. They also deployed expatriate lawyers, usually from the U.K. or the U.S. At their peak in 2007/2008, the largest Moscow offices of the international firms had 250 or more lawyers (the numbers went down afterwards). By early 2014, most of the largest global law firms had offices in Moscow and some in Saint-Petersburg as well. The foreign firms were mostly U.K. firms: all of the Magic Circle firms (minus one) came to Russia, plus the larger U.K. firms in the succeeding tiers; in all, about 15 or 20 U.K. (English) headquartered firms. Amongst the top U.S. firms, fewer chose to be present in Russia. Those who did, however, were quite successful.

For the first decade, no Russian firm could come close to competing with the foreign firms. Eventually four or five Russian firms were able to emerge, building on specialist practices in tax, securities, litigation, and intellectual property. Some of these new Russian firms were able to capture a growing portion of the market, handling increasingly large transactions that brought them into contact with colleagues from international firms, thereby enhancing their profile and visibility.

As a general rule, however, the market is still dominated by the foreign firms. This is very apparent if one looks at a few global legal directories

⁷⁹ Regulation on the Licensing of Paid Legal Services on the Territory of the Russian Federation, adopted by Resolution of the Government of the Russian Federation No. 344, dated 15 April 1995, accessible at <http://www.kommersant.ru/doc/11086>.

⁸⁰ Apparently the 1995 regulation was repealed in 1998. Genry Reznik, *Ne kardinalno reformirovat', a prosto uregulirovat'*, ZAKON, 9/2012, at 91-93.

⁸¹ Federal Law No. 63-FZ of 31 May 2002.

(Chambers, Legal 500, and IFLR).⁸² The international firms were able to secure their position by capitalizing on their competitive advantage in sourcing English law and cross-border transactional services. In the nineties, English law services first involved servicing the inbound lending activities of the international banks and international financial institutions. The work expanded to merger and acquisition activities structured around Cyprus and other holding company jurisdictions, and then, at the end of the nineties, to capital markets work supporting the initial public offerings and listings of Russian companies abroad, often in London.

Of course, the dominance of the U.S. and U.K. law firms is not specific to Russia.⁸³ A quick glance at international mergers and acquisitions league tables or professional directories shows that the leading global firms dominate in many of the top 20 economies—in the U.S., U.K., Germany, and France for example. But in other countries, such as Japan, Italy, Spain, Canada, or Australia, powerful local firms have remained independent and compete very well with the global firms. The picture is the same in the large emerging economies: in Brazil, China, India, South Africa and South Korea, local firms are dominant.⁸⁴ Even in continental European countries where the U.K. and U.S. firms have become dominant, such as France or Germany, their position was often achieved by merger or combination with strong local practices whose own culture and modes of practice survived and continue to exist (including corporate transactions and contentious work conducted under local law).

It is not so in Russia. There the international U.K. and U.S. firms expanded through endogenous growth fuelled by recruitment and training of junior lawyers, not through lateral acquisitions of existing firms.⁸⁵ In the absence of domestic regulations or any pre-existing market culture or practices, the foreign law firms transported home office practices and culture into their Russian offices *in toto*. This format of international legal services was already the expectation for foreign investors entering into

⁸² The susceptibility of these directories to reflect actual changes in the market is admittedly questionable, as much of their information is provided by incumbents rather than clients and their penetration amongst domestic Russian clients may be more limited than amongst international clients.

⁸³ *Exorbitant Privilege*, THE ECONOMIST, 10 May 2014, at 59.

⁸⁴ These observations on the strength of local law firms are based on a summary review of firm rankings in the practice area of Corporate and Mergers and Acquisitions (which usually represents a good proportion of the activity of commercial law firms), in the recent editions of the Chambers Global directory of law firms.

⁸⁵ There seems to be one exception to this rule: BLP, which acquired (or merged) with Russian firm Goldsblat.

Russia, but it also became the norm for Russian corporate clients whose in-house legal teams in Moscow needed to service the operations of their numerous foreign affiliates. There was a convergence of interests between the supply by foreign firms of resident dual-qualified teams of Russian and foreign lawyers and the demand of the Russian corporate community for cross-border legal assistance to service the needs of groups of companies that were already highly extra-territorial.

Which came first (a chicken and egg question)? Did foreign law firms achieve dominance because the Russian economic elites already had numerous existing foreign companies and affiliates; i.e., was this a case of firms following their clients' needs? Or did the foreign firms naturally push their Russian clients towards the generic use of law and corporate structures in which they were mostly qualified, including English law governed contracts and holding companies in common law jurisdictions?

The answer is that both are probably true. English law benefited from a network effect resulting from the widespread use of foreign and offshore corporate structures in common law jurisdictions.⁸⁶ Cyprus is a former British colony which applies the common law. Its company law is based on the 1948 English Companies Act. Many senior Cypriot lawyers received training in the U.K. and are admitted as English solicitors. The laws of the British Virgin Islands, Bermuda, Cayman Islands, Gibraltar, the Bahamas, Channel Islands and Isle of Man, all of which also appear at the top of Russian FDI lists (see Part I) are all based on the common law and follow English statutory models from prior decades. The highest judicial body in all of these territories and countries (though not Cyprus) is the Judicial Committee of the Privy Council sitting in London. Many or all of the lawyers in these territories are qualified both locally and in England. The use by Russian elites of corporate structures in these common law jurisdictions contributed significantly to the preference for English law and jurisdiction in their other business affairs as well.

Another factor explaining the dominance of English law and foreign firms was the size of Russian transactional work. For the years 2012 and 2013, Russia's GDP, at approximately \$2 trillion in nominal terms, was usually ranked eighth in the world⁸⁷ and ownership concentration within the

⁸⁶ On network effects in choice of law and forum, Bryan H. Duzin, *Buying Commercial Law: Choice of Forum, Choice of Law, and Network Effect*, 18 TULANE J. OF INT'L & COMP. LAW 131 (2009), available at: http://works.bepress.com/bryan_duzin/5

⁸⁷ 2012 figures by the IMF, World Economic Outlook Database, October 2013, <http://www.imf.org/external/pubs/ft/weo/2012/02/weodata>; World Bank, <http://data.worldbank.org/indicator/NY.GDP.MKTP.CD>.

Russian economy is high. As a result, transactions in Russia (in particular mergers and acquisitions) easily reached significant amounts. For such large transactions English law offered the necessary depth of case law and predictability of outcomes as well as resident solicitors already on the ground in Moscow working within international firms with decades of experience supporting similar transactions around the world.

Other more intangible factors may also have been at play. The English language is obviously dominant as a means of international communication (although this does not explain the preference for English law over, say, New York law). London and the London area have become the home of many senior Russian businessmen and their families. The protocol of the English legal profession (gowns and wigs) is impressive. To outsiders and clients, English contract law seems accessible. Cases are primarily fact driven and comparatively devoid of legal terminology or specialist content. Many of these court decisions can be accessed on the Internet directly (www.bailii.org) and make for an entertaining read. There is a pragmatic, non-judgmental quality in the manner in which English judges rule on situations, which may create a favorable contrast with the more critical approach of international business realities preferred by certain continental courts or perhaps some U.S. courts. All of this appealed to the economic elites of the former Soviet Union.⁸⁸

Finally, and perhaps most importantly, English law and jurisdiction were viewed by Russian businessmen as vastly preferable to the natural alternative, Russian law and jurisdiction. The Russian legal system and profession have long suffered from a traditional deficit of trust within their own society. This was already the case for lawyers and judges under the Soviet system, but the roots are deeper than that. Legal historians explain that law did not develop as an institution in Russia as it did in Western Christendom, that other social values had a greater role in forming Russian society and that law was not a factor of social cohesion in Russian culture.

The roots of Russia's complicated relationship with the law are found in centuries of czarist autocracy and bureaucratic arbitrariness (*proizvol*), in numerous unsuccessful attempts at wholesale legal reform,⁸⁹ and in decades

⁸⁸ Some suggest that pride or vanity may also play a role, for example Irina Paliashvili, *Do not put legal business under pressure*, RAPSI, 4 September 2013: "[...] businessmen with big money are flattered that their interests are represented by prominent English lawyers." http://rapsinews.com/judicial_analyst/20130904/268747518.html

⁸⁹ RICHARD S WORTMAN, *THE DEVELOPMENT OF A RUSSIAN LEGAL CONSCIOUSNESS* (1976), on the last pre-Soviet attempt at large scale Russian legal reform in 1864. See also Michael Newcity, *Why There is No Russian Atticus Finch? Or Even a Russian Rumpole?* 12 *TEXAS WESLEYAN L. REV.* 271-302 (2005).

of Soviet totalitarianism and dictatorship.⁹⁰ Admittedly, there is a bit of stereotype here; but still, this historical legacy continues to count. Public opinion polls repeatedly show that Russians still do not trust their courts. To the question “Do you think an ordinary person can have a fair hearing in court?,” 61 percent of respondents answer “no;” 63 percent of respondents think that honest judges are a minority (if they exist at all).⁹¹

The fight against Russian “legal nihilism” was one of the first policy themes expounded by Dmitry Medvedev during his presidency.⁹² The public perception of Russian lawyers is improving now, especially in the large cities, but there is still some way to go before achieving in Russia the level of respect that the legal profession carries with it in the United States, the United Kingdom, or many countries of continental Europe. In most mid-sized Russian companies the chief in-house lawyer occupies the rank of a mid-level executive; her role is significantly less important than, say,

⁹⁰ Harold Berman remains the most inspirational Western scholar of Russian and Soviet legal history. He writes that

again and again through the centuries Westerners [...] have been shocked and baffled by the relative lawlessness of Russian life. Compared to life in the West it has seemed to them haphazard, inconstant, arbitrary [...] at the same time they have been impressed by the warmth and spontaneity of the Russians, by their capacity for service and self-sacrifice, [...] by their amazing elan and energy. Historically weak in lawgivers and jurists, Russia has been from the beginning strong in heroes and in saints. [...] Many of the greatest Russians have despised the legalism of the West, where in the scornful words of the nineteenth century Slavophile I.V. Kireevsky, “brothers make contracts with brothers.” They have looked to spontaneous personal and administrative relationships rather than to the formality of law, with its time-consuming emphasis on due process and its rationalism.

HAROLD BERMAN, *JUSTICE IN THE USSR* 224 (1963).

⁹¹ Levada Center, *RUSSIAN PUBLIC OPINION 2009*, p. 96-97, tables 8.3.17 and 8.3.19, <http://www.levada.ru/sites/en.d7154.agava.net/files/Levada2009Eng.pdf>. An important comment, here, is that lack of trust in the Russian courts does not mean that Russians never use them. On why Russians (individuals and corporate entities) use the courts, see Kathryn Hendley, *The Puzzling Non-Consequences of Societal Distrust of Courts: Explaining the Use of Russian Courts*, 45 *CORNELL INT’L L.J.* 517 (2012). The low cost and relative speed of litigation are two reasons. Another reason (not listed by Hendley) is that regardless of the outcome, litigation is often necessary in order to achieve tax deduction of some commercial losses.

⁹² *Laying down the law: Medvedev vows war on Russia’s “legal nihilism”*, *FINANCIAL TIMES*, 24 December 2008, <http://www.ft.com/intl/cms/s/0/e46ea1d8-c6c8-11dd-97a5-000077b07658.html#axzz30nC53SLP>.

that of the chief accountant (the chief accountant is in fact an important corporate officer).⁹³ In the largest companies that are listed abroad or in Moscow the general counsel may sit on the executive board, but this is not the case outside of this small circle of companies.

For all of these reasons, Russian senior corporate decision makers preferred foreign law for their large business operations. State-owned companies were no different. In late 2012, Rosneft acquired TNK-BP from its shareholders BP and AAR (a consortium of Russian shareholders) for a combined value of \$56 billion in what was possibly the world's largest merger and acquisition transaction that year.⁹⁴ Despite Rosneft being majority owned and controlled by the Russian state, the target being the fourth largest Russian oil company and half of the sellers being Russian individuals, the law firms involved in this transaction were all foreign.⁹⁵ No Russian law firm was involved.

B. The foreign courts

This section will focus on the English courts, which enjoy a unique position in relation to Russian disputes. I also propose to widen the discussion to cases involving not only Russia, but other former Soviet states also, in particular Ukraine, Kazakhstan, Tajikistan, and Kyrgyzstan. The purpose of this section is not to review English rules of civil and commercial jurisdiction, but only to illustrate why the courts had jurisdiction in cases that concerned transactions or events that had occurred exclusively in Russia (or Ukraine, Kyrgyzstan, etc.) between foreign (Russian, Ukrainian, etc.) individuals (or their corporate creatures) with little or no nexus to England.

Clearly, jurisdictional determination depends on the precise circumstances of each dispute; but, in general, there are three situations in which the English courts have jurisdiction in FSU disputes:

⁹³ See also Kathryn Hendley, *The Role of In-House Counsel in Post-Soviet Russia in the Wake of Privatization*, INTERNATIONAL JOURNAL OF THE LEGAL PROFESSION, (forthcoming), UNIV. OF WISCONSIN LEGAL STUDIES RESEARCH PAPER No. 1088, available at SSRN (July 26, 2009).

⁹⁴ *Mergermarket M&A roundup for 2012*, 11 January 2013, at 6. The two Rosneft transactions were reported separately, ranking No. 4 and 5 for 2012.

⁹⁵ *Mergermarket ibid*, at 6. The firms were announced to be Cleary Gottlieb Steen & Hamilton, Cravath Swaine & Moore, Linklaters, Akin Gump Strauss Hauer & Feld, Conyers Dill & Perman, Skadden Arps Slate Meagher & Flom, Weil Gotshal & Manges, and White & Case.

- 1) (i) *personal jurisdiction*, i.e., cases in which the defendants are now domiciled in England;
- 2) (ii) *party autonomy*, i.e., cases where the defendants have in one way or another chosen, or voluntarily submitted to, English jurisdiction; and
- 3) (iii) cases in which an English court finds itself competent *despite* the objections of the defending party following a discretionary determination by the court that it is the appropriate forum to hear the case (*forum conveniens*) in comparison with the foreign alternative forum which is not deemed appropriate.

1. *Personal jurisdiction*

London and the London area are by far the preferred place for elites from the former Soviet Union to establish a private residence abroad (for them and their families). It is also the favorite destination for those who for whatever reason have fallen out of political favor. Boris Berezovsky, a prominent political exile, was a major source of litigation in the English courts, both as claimant and defendant.⁹⁶ The English courts had personal jurisdiction for the adjudication of claims either when these individuals were themselves defendants⁹⁷ or when the defendants were their English registered personal holding companies.⁹⁸

The circumstance that the facts in dispute occurred fifteen or twenty years previously, exclusively in Russia or another former Soviet country, and before any of the parties took up residency in England was not an obstacle. When dealing with disputes without a clear nexus to England, the traditional position of the English courts is determined in accordance with their doctrine of *forum non conveniens*;⁹⁹ in general terms, *forum non conveniens* is declared in England

⁹⁶ A search on www.bailii.org in January 2014 turned up no less than 29 cases in which Berezovsky appeared either as claimant or defendant.

⁹⁷ *JSC BTA Bank v Ablyazov* [2010] EWHC 1779 (Comm) (16 July 2010); *Fiona Trust & Holding Corporation Ors v Privalov Ors* [2010] EWHC 3199 (Comm) (10 December 2010); *Joint Stock Company (Aeroflot - Russian Airlines) v Berezovsky & Anor* [2012] EWHC 3017 (Ch) (30 October 2012); *Tajik Aluminium Plant v Ermatov & Ors* [2005] EWHC 2241 (Ch) (21 October 2005).

⁹⁸ *Contra* see *Yugraneft* in which Millhouse Capital, Roman Abramovich's English holding company, was not found to be a proper defendant (*supra* note 27).

⁹⁹ On the English doctrine of *forum non conveniens* see DICEY, MORRIS & COLLINS, *CONFLICT OF LAWS*, Chapter 12, ¶¶ 12-001 to 12-051.

...when the court is satisfied that there is some other available forum, having competent jurisdiction, which is the appropriate forum for the trial of the action, i.e., in which the case may be tried more suitably for the interests of all the parties and the ends of justice.¹⁰⁰

However, this defense must be raised by a defendant, which is certainly not automatic in the FSU cases. In addition, *forum non conveniens* is no longer possible under the Brussels regime¹⁰¹ when the defendant is domiciled in the U.K. (or any other member state), following the 2005 *Owusu v Jackson*¹⁰² decision of the European Court of Justice.¹⁰³

2. Party autonomy

Contractual selection of English law and jurisdiction was the second significant jurisdictional anchor for the English courts. As pointed out in Part I, much of significant in-bound lending, merger and acquisition, and other contractual activities involving transfers of funds in and out of Russia (and other FSU states) were placed under English law and English jurisdiction in the last two decades, including under bifurcated clauses allowing plaintiffs to take their case either to the LCIA or to the English courts. In such cases, the jurisdiction of the English courts was founded on the contractual jurisdictional agreement or on the arbitration clause designating the LCIA or other arbitration with an English seat. The underlying principle is respect for party autonomy: If parties have agreed to refer their dispute to the English courts (or English arbitration), then this

¹⁰⁰ *Spiliada Maritime Corp v Cansulex Ltd* [1987] AC 460, at 476.

¹⁰¹ The European or Brussels regime means the rules on jurisdiction in civil and commercial matters set out in Regulation (EU) No. 44/2001 (the “Brussels I Regulation”) and recast in Regulation (EU) No. 1215/2012 of 12 December 2012 (the “Brussels I Regulation Recast”), the latter being applicable from 10 January 2015.

¹⁰² *Owusu v Jackson* (Case 2-281/02) ECR I-1383, 1st March 2005. *Owusu* concerned a tort claim against a defendant domiciled in England (and also several Jamaican companies). The English court was tempted to send the case to Jamaica as the most appropriate forum, but the ECJ found that when a defendant was domiciled in England, English jurisdiction was mandatory.

¹⁰³ *Owusu* was very criticized in England as curtailing the ability of common law judges to exercise discretion. See for example Adrian Briggs, *The Impact of Recent Judgments of the European Court on English Procedural Law and Practice*, II ZEITSCHRIFT FÜR SCHWEIZERISCHES RECHT, No. 124 (2005), at 231-262, OXFORD LEGAL STUDIES RESEARCH PAPER No. 11/2006, April 2006, available at SSRN; Edwin Peel, *Forum Shopping in the European Judicial Area - Introductory Report*, UNIVERSITY OF OXFORD FACULTY OF LAW LEGAL STUDIES RESEARCH PAPER SERIES, Working Paper No 39/2006, September 2006, available at SSRN.

agreement must be upheld even if there are no other elements providing nexus to England and even if England might not be a “natural” forum. In the words of Adrian Briggs: “if the parties to a dispute wish the English court to exercise jurisdiction, the court will do so.” This is

...entirely in keeping with the laissez-faire approach of the English courts to these [jurisdictional] issues, and it may be one of the reasons why the jurisdiction of the English commercial court is so attractive to persons who have no connection to England.¹⁰⁴

Sometimes, Russian defendants, although not residing in England nor having submitted to English jurisdiction via contractual jurisdictional agreement, nevertheless consented to English jurisdiction after the case had been filed. In *Yugraneft*, Roman Abramovich was determined not to be domiciled in the United Kingdom and the judge did not give permission to serve him out of the jurisdiction.¹⁰⁵ Nevertheless, in the *Berezovsky v Abramovich* proceedings that took place later, Abramovich decided not to challenge the jurisdiction of the English court (as he had successfully done so in *Yugraneft*).¹⁰⁶ Another example is when both sides to a Russian dispute decide to take their case to the English courts for resolution, despite the absence of any English connection such as a contract governed by English law or a place of registration in England.¹⁰⁷ The preference of the Russian economic elites for English court jurisdiction must of course be viewed as the corollary of their rejection of the natural alternative—Russian jurisdiction and courts. The policy question this raises for the international

¹⁰⁴ Briggs, *ibid*, at 6. It must be said here that the English approach to party autonomy is shared by many other jurisdictions, the global trend being to uphold jurisdictional agreements except in the face of very powerful circumstances. In the United States, the original decision was *Bremen v Zapata (M/S Bremen v. Zapata Off-Shore Co.)*, 407 U.S. 1 (1972), and more recently *Atlantic Marine Constr. Co. v. United States District Court for the Western District of Texas*, 571 U.S. ___ (2013) (http://www.supremecourt.gov/opinions/13pdf/12-929_olq2.pdf). In France jurisdictional clauses (“*clauses de prorogation de compétence territoriale*”) are permitted in domestic contracts when in writing and between commercial parties (article 48 of the Civil Procedure Code); the use of such clauses in the international arena was recognized in *Cass. Civ. I*, 17 December 1985, *CSEE v SORELEC*, *Recueil Dalloz* 86.I.R.265 obs. Audit).

¹⁰⁵ *OJSC Oil Company Yugraneft v Abramovich & Ors* (Rev 1) [2008] EWHC 2613 (Comm) (29 October 2008), ¶¶ 487, 499 and 500.

¹⁰⁶ *Berezovsky v Abramovich* (Rev 1) [2012] EWHC 2463 (Comm) (31 August 2012), at ¶4.

¹⁰⁷ *Bank St Petersburg & Anor v Savelyev & Anor* [2013] EWHC 3529 (Ch) (14 November 2013), and subsequent proceedings, regarding a dispute between a Russian bank and Russian individuals in connection with several Russian port companies.

legal order is whether jurisdiction should be primarily determined by individual litigants in this way without courts being able to take a different view for themselves.

Generally, the power of party autonomy expressed in jurisdictional clauses is now solidly established, in European national systems of private international law (such as France and England) and in the Brussels regime.¹⁰⁸ In addition to an express jurisdictional agreement, the 2001 Brussels I Regulation used to require that at least one of the litigating parties be domiciled in the EU. This domiciliary requirement was removed in the Brussels I Regulation Recast, meaning that a jurisdictional agreement between non-EU parties that designates an EU court will now become binding on that court regardless of the particular circumstances.¹⁰⁹

3. *Service out of the jurisdiction*

A third category of cases was when, absent a jurisdictional agreement or voluntary submission to the jurisdiction, the English courts found themselves competent despite the objections of the foreign defending parties. These cases were less frequent, but as an expression of long arm jurisdiction they attracted a lot of attention. In such matters, the English courts make a discretionary determination as to whether England is *forum conveniens* or *forum non conveniens*. This is not so much an absolute exercise as a comparative one with the other possible forum, which proceeds in two stages: first, a determination of which forum (England or

¹⁰⁸ *Supra* note 104. Party autonomy under the Brussels I Regulation was considered by many commentators (including English commentators) to have been impaired by the ECJ decisions in *Gasser* (Case C-116/02, Erich Gasser GmbH v. MISAT Srl., 2003 E.C.R. I-14693, regarding *lis pendens* and the “Italian torpedo”), *Turner* (Case C-159/02, Gregory Paul Turner v. Felix Fareed Ismail Grovit, Harada Ltd., 2004 E.C.R. I-3565, regarding anti-suit injunctions) and *West Tankers* (Case C-185/07, Allianz SpA & Generali Assicurazioni Generali SpA v West Tankers Inc., 2009 WL 303723 (Feb. 10, 2009), regarding arbitration clauses). These difficulties were partially rectified in the 2012 Brussels I Regulation Recast.

¹⁰⁹ Compare Article 25 of Regulation (EU) No. 1215/2012 with Article 23 of Regulation (EU) No. 44/2001. A leading French textbook writes that:

...this raises the question whether a designated court will be able to decline jurisdiction in the absence of any jurisdictional anchor other than its designation by the parties; some States will be sensitive to the economic benefits deriving from the activities of the courts, while others will prefer to avoid court engorgement and prioritize the hearing of local cases.

(Bernard Audit and Louis d’Avout, *DROIT INTERNATIONAL PRIVÉ* (2013), ¶624, footnote 3 at page 545, and also ¶629).

the FSU country) is *the natural forum*, i.e., the one with the closest connection to the case; and second, if the natural forum is the foreign one, should the English court grant a stay or strike out the proceedings (or on the contrary give permission to serve out), on the basis that justice will not be done in the foreign natural forum.¹¹⁰

The most spectacular example of permission to serve abroad was the *Cherney v Deripaska* decision of 2008.¹¹¹ Together with *Berezovsky v Abramovich*, this case is probably the largest and most striking Russian dispute heard in England to date, so it is worth offering a short summary of it.

The plaintiff Michael Cherney was an ex-Soviet businessman who was born in Ukraine and grew up in Uzbekistan. He emigrated in 1994 and now lives in Israel. Oleg Deripaska, the defendant, was the core shareholder of Rusal, the largest aluminum producer in the world, and very rich (number nine on the 2008 Forbes billionaires list with an estimated net worth at the time of \$28 billion¹¹²). Cherney filed suit against Deripaska in London to claim ownership of 20 percent of Rusal (representing several billion U.S. dollars). Deripaska, however, was not domiciled in England and therefore permission to serve out of the jurisdiction had to be requested before the proceedings could start. In 2008, the judge (Christopher Clarke J) gave the court's permission. He acknowledged that Russia was the natural forum for the litigation; however,

¹¹⁰ Service out of the jurisdiction is possible when the three tests set out in the reference decision *Spiliada* are satisfied. The first test is that there must be a serious case to be tried on the merits. The second test is that there must be a good arguable case that the claim against the foreign defendant falls within one of several jurisdictional gateways available for service out of the jurisdiction (under paragraph 3.1 of Practice Direction 6B supplementing Section IV of the Civil Procedure Rules Part 6 (CPR Part 6, PD 6B)); these involve circumstances such as being a "proper and necessary defendant", a tort having occurred in England, a contract being governed by English law or a jurisdictional clause designating an English court. The test here is that there is "a good arguable" case only and this is not a final determination on the merits. The third requirement is the one regarding *forum conveniens/non conveniens*: "the claimant must satisfy the court that in all the circumstances England is clearly or distinctly the *appropriate* forum for the trial of the dispute and that in all the circumstances the court ought to exercise its discretion to permit service of the proceedings out of the jurisdiction" (*VTB Capital Plc v Nutritek International Corp & Ors* [2012] EWCA Civ 808 (20 June 2012), ¶100). The *appropriate* forum may not always be the *natural* forum and England can displace a foreign *natural* forum if the latter is found inappropriate.

¹¹¹ *Supra* note 19.

¹¹² It seems to have gone down since, at least if one looks at the Forbes listings in later years.

...the risks inherent in a trial in Russia (assassination, trumped up charges, and lack of a fair trial) [were] sufficient to make England the forum in which the case [could] most suitably be tried in the interests of both parties and the ends of justice.¹¹³

Cherney, a colorful character to say the least, was indeed *persona non grata* in Russia and successfully argued that he would incur significant personal risk if he were to return there for a trial. Ironically, it subsequently transpired that he would also be unable to attend court hearings in London, following an Interpol warrant that had been issued on suspicion of money laundering in Spain, so the court had to authorize him to appear by video link. Comments in the professional press at the time were that “the feud between the two [litigants] is typical of the type of dispute the [English] government wants to attract to London. Significant both in terms of ramifications and legal costs.”¹¹⁴ The ramifications presumably included the portion of the case dealing with the quality of the Russian legal system and whether Cherney could expect a fair trial there.

The debate on this question was lengthy and involved voluminous evidence and expert testimony by Western academics. Eventually the judge decided that “cogent evidence” had been presented to the court to convince it that the case would never go to trial in Russia and that even if it did Cherney would be at significant personal risk, and so the case was allowed to proceed in England. The main hearings were scheduled for October 2012. The parties, however, preferred to settle the case before the hearings on undisclosed terms, and so the public (including the Russian public) will never know which, of Cherney or Deripaska, would have ultimately prevailed in the eyes of the English judges.¹¹⁵

A quick look at some of the cases over the last years shows that in addition to *Cherney v Deripaska*, permission to serve out of the jurisdiction against Russian (or other former Soviet) defendants was given (and then sometimes overturned) quite frequently (for example, in *AK Investments*,¹¹⁶

¹¹³ *Id.*, ¶264.

¹¹⁴ *Top Cases 2012*, THE LAWYER, 2 January 2012, <http://www.thelawyer.com/top-20-cases-2012/1010744.article>; *Another day, another feuding oligarch dollar as Cherney v Deripaska resumes*, THE GUARDIAN, 22 September 2012, <http://www.theguardian.com/business/2012/sep/23/feuding-oligarchs-business-agenda>.

¹¹⁵ *Deripaska and Cherney make surprise deal out of court*, THE GUARDIAN 27 September 2012, <http://www.theguardian.com/world/2012/sep/27/deripaska-cherney-surprise-deal>

¹¹⁶ *Supra* note 29.

Arros Invest Ltd v Nishanov,¹¹⁷ *Harley Street Capital Ltd. v Tchigirinsky*,¹¹⁸ *VTB v Nutritek*,¹¹⁹ *Tajik Aluminium Plant v Ermatov*,¹²⁰ *Alliance Bank v Aquanta*,¹²¹ *AES Ust-Kamenogorsk Hydropower Plant*,¹²² and *Erste Bank v Red October*.¹²³

¹¹⁷ *Arros Invest Ltd v Nishanov* [2004] EWHC 576 (Ch) (17 March 2004). The case was about a claim by an English company being wound up against its former Russian directors.

¹¹⁸ *Harley Street Capital Ltd. v Tchigirinsky & Ors* [2005] EWHC 1897 (Ch) (25 August 2005). The case was about a claim for unlawful dilution in Sibir Plc, a company invested in Russian oil and gas assets and listed in London, which now belongs to the Gazprom group.

¹¹⁹ *VTB Capital Plc v Nutritek International Corp & Ors* [2011] EWHC 3107 (Ch) (29 November 2011). The case was about a claim for misrepresentation and fraud against certain Russian borrowers and their beneficial owners, in connection with a loan to fund the acquisition of dairy farms. The decision not to allow service out of the jurisdiction was upheld by the Court of Appeals and Supreme Court (see references *supra* at note 39).

¹²⁰ *Tajik Aluminium Plant v Ermatov & Ors* [2005] EWHC 2241 (Ch) (21 October 2005) (and subsequent proceedings). The case was about alleged fraud committed by Tajik individuals and companies under their control at a large state-owned aluminum plant in Tajikistan.

¹²¹ *Alliance Bank JSC v Aquanta Corporation & Ors* [2012] EWCA Civ 1588 (12 December 2012). The case was about alleged fraud committed at a Kazakh bank by a group of Kazakh individuals and BVI companies under their control.

¹²² *AES Ust-Kamenogorsk Hydropower Plant LLP v Ust-Kamenogorsk Hydropower Plant JSC* [2011] EWCA Civ 647 (27 May 2011). The case involved claims by AES against Kazakh state-owned entities for breach of contract in connection with a power plant concession.

¹²³ *Erste Group Bank AG (London Branch) v JSC “VMZ Red October”* [2013] EWHC 2926 (Comm) (03 October 2013). The case involved a loan agreement and a guarantee signed between an Austrian bank (acting through its English branch), a Russian borrower, Red October, and its guarantor, both agreements being subject to English law with dispute resolution in the English courts. The Russian debtor and guarantor defaulted under the agreements, as a result of which the claimant filed suit in the London High Court. As is the practice in such cases additional companies were named as co-defendants, although they were not party to the agreements, and amongst these companies was the state-owned company Russian Tekhnologia. The court found that there was a “serious arguable case” that these additional companies were “necessary and proper parties” to the lawsuit, in addition to the anchor defendants that were parties to the jurisdictional agreement (this was one of the English jurisdictional gateways). The court also found a “serious arguable case” that damage had been sustained in England. Evidence was therefore found that England (not Russia) was the natural forum, meaning that it

4. Comity, corruption and Russian politics

The English jurisdictional approach, while operating widely in some circumstances, is certainly not one-sided; reluctant foreign defendants are not systematically dragged into English courts against their will nor are Russian claimants always successful in their preference to litigate in the English courts. There are a number of cases in which permission to serve out of the jurisdiction was denied.¹²⁴ In the case concerning the largest Ukrainian iron ore mine (Ferrexpo),¹²⁵ the English judge accepted an innovative “reflexive” interpretation of the Brussels I Regulation in favor of Ukrainian court proceedings and stayed his own proceedings,¹²⁶ rejecting the plaintiffs’ argument that they would not obtain justice in Ukraine. In a case involving fraud committed by Kazakh defendants at a Kazakh bank, England was not found to be the appropriate forum, the judge citing a 1885 precedent decision:

It becomes a very serious question, and ought always to be considered a very serious question, [...] whether this court ought to put a foreigner, who owes no allegiance here, to the inconvenience and annoyance of being brought to contest his rights in this country

was no longer necessary for the court to review the claimant’s chances of obtaining justice in the alternative forum, i.e., Russia.

¹²⁴ *High Tech International v Deripaska* [2006] 3276 QB (20 December 2006) (as regards service on Deripaska), *OJSC Yugraneft v Abramovich, Millhouse and Berezovsky (Rev 1)* [2008] EWHC 2613 (29 October 2008) (as regards service on Abramovich), *VTB Capital plc v Nutritek and others* [2012] EWHC Civ 808 (20 June 2012), *VTB Capital plc v Nutritek and others* [2011] EWHC 3107 (ch) (29 November 2011). VTB being state-owned, its line of argument did not include any allegation that it would not receive a fair trial in Russia.

¹²⁵ *Ferrexpo AG v Gilson Investments Ltd & Ors* [2012] EWHC 721 (Comm) (03 April 2012), ¶96.

¹²⁶ “Reflexive” application in favor of third country courts was introduced in December 2012 under the Brussels I Regulation Recast (Articles 33 and 34), in cases when a member state court is seised under Article 4 (domicile of the defendant) or Articles 7, 8 or 9 on special jurisdiction (but not under Article 24 regarding exclusive jurisdiction in matters such as immovable property, corporate affairs or entries in public registers). The new provisions confer a limited discretion upon EU courts to stay their own proceedings in favor of non-EU courts, if certain requirements are satisfied (the non-EU proceedings must already be under way and they must be capable of recognition and enforcement in the EU member state). French commentators have noted that these requirements are narrower than those that would apply under French domestic law. Jean-Paul Beraudo, *Regards sur le nouveau règlement Bruxelles I sur la compétence judiciaire, la reconnaissance et l’exécution des décisions en matière civile et commerciale*, JDI (Clunet) 2013, doctr. 6., p. 741, ¶34. They are also narrower than the English decision in *Ferrexpo*.

and I for one say, most distinctly, that I think this court ought to be exceedingly careful before it allows a writ to be served out of the jurisdiction.¹²⁷

In *Star Reefers*, in circumstances not wholly dissimilar to those of another case which set off a furor in Moscow (*BNP Paribas v Russian Machines*, more on this later), the judge declined to issue an anti-suit injunction against a Russian company that had not signed up to an English jurisdictional clause. The judge thought that an injunction in such a case would be contrary to comity: “there is, as it seems to me, something of a touch of egoistic paternalism in an English court enjoining continuation of the foreign proceedings in such a case.”¹²⁸ One could also add a recent judgment refusing to accept jurisdiction in a contract claim filed by the wife of the former mayor of Moscow (now residing in England) against one of her Russian business partners, despite the selection of English law to govern the contract, on grounds of “overwhelming” links with Russia.¹²⁹

In addition, the English judges themselves did not always welcome these time consuming post-Soviet cases and submissions. One of the earlier cases, *Base Metal Trading v Shamurin*, was described by the judge as “lamentable litigation.”¹³⁰ Many lengthy jurisdictional determinations, in particular, were found to be “excessively complicated” or to involve “wholly disproportionate” volumes of materials and costs incurred by clients.¹³¹ The concerns of the judges echoed some views that appeared in

¹²⁷ *Alliance Bank JSC v Aquanta Corporation & Ors* [2012] EWCA Civ 1588 (12 December 2012), at ¶44, citing *Société de Générale de Paris v Dreyfus Brothers* (1885) 29 Ch. D. 239 at page 242.

¹²⁸ *Star Reefers Pool Inc v JFC Group Co Ltd* [2012] EWCA Civ 14 (20 January 2012), ¶39.

¹²⁹ *Baturina v Chistyakov* [2013] EWHC 3537 (Comm) (14 November 2013)

¹³⁰ *Base Metal Trading Ltd v Shamurin* [2003] EWHC 2606 (Comm) (06 November 2003), ¶12. Ironically, it seems that the legal fees incurred in that case were just about equal to the total amount of the claim.

¹³¹ In *AK Investments* (*supra* note 29, at ¶7), Lord Collins comments that:

...this case has been excessively complicated by any standards. The hearings [...] each lasted for 4 days or more. The hearing before the [Privy Council] Board lasted 4 days. The written cases of the parties exceeded 200 pages, and more than 30 volumes of documents were placed before the Board, containing almost 14,000 pages, as well as 170 authorities in 12 volumes. The core bundle alone consisted of six volumes. The list of “essential” pre-reading for the Board listed documents totaling some 700 pages. All of this was wholly disproportionate to the issues of law and fact raised by the parties.

the general press, the *Financial Times* writing at one point that “some question whether the U.K. should ‘rent out’ its legal system to companies and litigants who may have little link with the country.”¹³² This is a delicate topic of which I propose to examine two aspects only, primarily from a Russian institutional angle: first, the extensive criticism of the Russian (or other ex-Soviet) legal system that it involved; and second, the highly political nature of some of these cases.

I. Criticism of the Russian legal system

The wave of FSU litigation gave an entirely new dimension to the review by English courts of the quality of foreign courts and whether they are able to deliver justice. Dicey, Morris, and Collins point out as much in their last edition (2012). They write that until recently, in *forum non*

In *Yugraneft* (*supra* note 27, Appendix 6 at 1 and 5), the judge complains that there were 45 volumes of materials and that on occasion the “compilation was eccentric”. In *Erste Bank v Red October* (*supra* note 123, at ¶10):

the importance of the need to avoid a detailed exploration of the merits at the stage of a challenge to the jurisdiction is of particular significance in the present case where the Court is faced with 17 lever arch files of evidence, with [the defendants] seeking to challenge [the claimant] on almost every point and seeking to rebut what [the claimant] says in reply

In *VTB v Nutritek* (VTB Capital plc v Nutritek and others [2012] EWHC Civ 808 (20 June 2012), ¶¶82 and 83):

...hearings concerning the issue of appropriate forum should not involve masses of documents, long witness statements, detailed analysis of the issues, and long argument. It is self-defeating if, in order to determine whether an action should proceed to trial in this jurisdiction, the parties prepare for and conduct a hearing which approaches the putative trial itself, in terms of effort, time and cost. There is also a real danger that, if the hearing is an expensive and time-consuming exercise, it will be used by a richer party to wear down a poorer party, or by a party with a weak case to prevent, or at least to discourage, a party with a strong case from enforcing its rights.... It is simply disproportionate for parties to incur costs, often running to hundreds of thousands of pounds each, and to spend many days in court, on such a hearing.

¹³² *Oligarchs pick London to do battle*, FINANCIAL TIMES, 17 February 2012. But the journalists point out that “lawyers welcome the business.” There is an active institutional effort to promote London as an international dispute resolution center, which is illustrated by the www.unlockingdisputes.com website maintained by CityUK (a promotional agency), the Bar Council (representing barristers), and the Law Society of England and Wales (representing solicitors). The development efforts particularly target Russian and Chinese disputes.

conveniens cases, litigants were unwilling to enter arguments that were too overly critical of the foreign court, realizing that “if they sought to make the argument to resist a stay but did not prevail, it would be embarrassing to have to make their claim before the foreign court which they had so criticized.” Russian or other litigants from the former Soviet Union, having little or no respect for their home country courts to begin with, felt no such compunction, leading Dicey to acknowledge an increase in the English courts’ acceptance of jurisdiction on foreign disputes specifically centering on the former Soviet Union.¹³³

Not surprisingly, this voluminous critical material was not well received in Russia (see Part IV). Such levels of criticism, however, also seem to raise questions on the role of comity in English law. The conundrum is expressed by Adrian Briggs thus:

If an English court is to rule on such a submission [e.g., that adjudication in Russia would be substandard¹³⁴], it is plain that its decision may seem impertinent, or far worse, in the eyes of the foreign State whose judicial institutions are impugned; but if it holds that it cannot entertain such a contention, it may be allowing justice to individual litigants to be sacrificed to political correctness, or to comity. What is to be done?¹³⁵

The difficulty then is how to reconcile the requirements of comity and international allocation of adjudicatory jurisdiction with the individual rights of litigants who want their claim to be heard in a certain court (here, an English court). Under the heading “bad countries make hard law” (which in all fairness does not refer to Russia or any named country), Professor Briggs concludes that whilst some of these proceedings might in fact be viewed as offending comity, English judges had no choice but to hear these cases thereby giving effect to the fundamental right to a fair trial posed by Article 6 of the ECHR. He suggests, however, that this may not be a desirable outcome.

II. Corruption and the Russian political system

The other problematic aspect of this wave of litigation touched on the nature of some of the disputes. The largest cases revolved around hugely politically charged questions of corruption, post-Soviet economic

¹³³ Dicey, Morris & Collins (2012), *supra* note 99, at 12-041.

¹³⁴ Text in between brackets inserted by me.

¹³⁵ Adrian Briggs, *The Principle of Comity in Private International Law*, COLLECTED COURSES OF THE HAGUE ACADEMY OF INTERNATIONAL LAW, Volume 354 (2012), at 124.

governance, and property redistribution. *Cherney v Deripaska* was about the privatization of the Russian aluminum industry (one of the largest in the world). *Berezovsky v Abramovich* was about the ownership of Rusal and Sibneft, the latter now a part of Gazprom. *Yugraneft* was about the sale of Sibneft to Gazprom by Roman Abramovich (not its central question, but a very important one). These cases centered on the privatizations of the nineties and the incestuous relation between property rights and political power in the Russian governance model, which subsists to this day. Such themes can arguably be viewed as being beyond the pale of legal logic in a private commercial context.

Even when one is only somewhat familiar with the complexities of the issues (Russians and foreigners alike), one is struck by the enormous efforts of lawyers and judges running these cases to explain the actions of individuals who were involved in these asset redistributions. In *Cherney*,¹³⁶ the judge sought to understand whether a one page document signed in 2001 at a London hotel documented a sale of shares or whether it “was a vehicle for the payment of protection money”¹³⁷—the payment was \$250 million that Deripaska would have to pay to Cherney and did indeed pay some time later. A few paragraphs earlier, the judge had cited expert witness testimony according to which Cherney “enjoyed the protection of Oleg Soskovets, who was first Minister of Metallurgy and then First Deputy Russian Prime Minister and other important officials.”¹³⁸ So the second option was for the money to be, in fact, a corruption payment. The first option was that it was payment for the purchase of shares. However, the judgment describes the general manner of acquisition of shares in the aluminum industry thus:

[Deripaska] began to purchase shares in Saaz [Sayansky, one of the key facilities] in 1993 and was by 1994 its largest private shareholder [...]. At that time the aluminum business in Russia was the subject of often violent struggles for control by factions that were sometimes connected to organised crime groups [...], which in turn had contacts with corrupt members of the security services and government ministries.¹³⁹

Does this mean that the original title to the shares was challengeable or should be placed under the scrutiny of the court? Clearly, neither of the two litigants had any incentive to question the quality of original title, so it was

¹³⁶ *Cherney v Deripaska*, *supra* note 19.

¹³⁷ *Id.*, ¶ 118.

¹³⁸ *Id.*, ¶ 60.

¹³⁹ *Id.*, ¶¶ 58 and 59.

not a topic that they were going to bring up *sua sponte*. The case eventually settled; it is therefore unclear whether this question would have been raised in the main proceedings.

There are similar difficulties in *Berezovsky v Abramovich*. Abramovich's central factual defense is that

...in return for substantial cash payments to Mr. Berezovsky, Mr. Abramovich and Sibneft would enjoy Mr. Berezovsky's political patronage and influence, which was indispensable to the construction of any major business in the conditions of the 1990s, the Russian term for such support being "krysha" (literally translated "roof").¹⁴⁰

Here too, the question was whether payments to Berezovsky were returns on equity investments or corruption payments. Ultimately, there were very few legal issues involved in the proceedings. The final determination was based mainly on the judge's perception of the truthfulness of the two individuals (both of whom had been active participants in business transactions that were, at best, murky). "Because of the nature of the factual issues, the case was one where, in the ultimate analysis, the court had to decide whether to believe Mr. Berezovsky or Mr. Abramovich."¹⁴¹ Berezovsky was found to be "an unimpressive, and inherently unreliable, witness, who regarded truth as a transitory, flexible concept, which could be molded to suit his current purposes."¹⁴² Abramovich, on the other hand, was found to be "a truthful, and on the whole reliable, witness."¹⁴³ These findings on truthfulness contrast with one of the judge's earlier comments that seemed to imply that the impression of truthfulness may have, in part, been attributable to the work of the lawyers.¹⁴⁴

¹⁴⁰ *Berezovsky v Abramovich*, *supra* note 20, ¶ 18. The paragraph numbers in this paragraph refer to the executive summary available at www.bailii.org.

¹⁴¹ *Id.*, ¶ 32.

¹⁴² *Id.*, ¶ 34.

¹⁴³ *Id.*, ¶ 43. One is tempted to object that both litigants were products of a system that rewarded the ability to mask one's emotions, character, and intentions. On this characteristic of the Soviet system, see ORLANDO FIGES, *THE WHISPERERS* (2007). As it happens, it seems that portions of Berezovsky's testimony were indeed very inconsistent, apparently giving firmer grounds to the judge's perception of his untruthfulness.

¹⁴⁴ "Given the substantial resources of the parties, and the serious allegations of dishonesty, the case was heavily lawyered on both sides. That meant that no evidential stone was left unturned, unaddressed or unpolished. Those features, not

It is striking that throughout its 500 pages, the judgment contains very little criticism of the manner in which business was conducted between the two protagonists.¹⁴⁵ On the inherently corrupt nature of the relations between Abramovich and Berezovsky, the judge writes that “Mr. Sumption [Abramovich’s lead barrister] accepted that Mr. Abramovich was privy to that corruption but submitted that the reality was that that was how business was done in Russia in those times.”¹⁴⁶ On the loan-for-shares auction of Sibneft shares, the judge’s view was that “it is not necessary for me to comment upon, let alone decide, whether the [...] authorisation, or conduct of the auction was corrupt or unlawful practice as a matter of Russian law at the time.”¹⁴⁷ On the falsification of reports to banks regarding the nature of the payments made to Berezovsky, she writes that “Whilst such description is one that might justifiably be open to criticism in a Western accounting context, as providing a false explanation, its use was understandable in the circumstances.”¹⁴⁸ On Abramovich’s incorrect statements to the press as to his actual ownership percentage in Sibneft: this fact had “some adverse effect on [his] credibility”, however the effect was not so serious as to disregard his evidence in relation to that issue.¹⁴⁹ The judgment came out in favor of Roman Abramovich; it did not receive voluminous coverage in the Russian legal press, but what coverage existed was generally positive.¹⁵⁰ If

surprisingly, resulted in shifts or changes in the parties’ evidence or cases, as the lawyers microscopically examined each aspect of the evidence and acquired a greater in-depth understanding of the facts. It also led to some scepticism on the court’s part as to whether the lengthy witness statements reflected more the industrious work product of the lawyers, than the actual evidence of the witnesses” *Berezovsky v Abramovich* (Rev 1) [2012] EWHC 2463 (Comm) (31 August 2012), executive summary of judgment at ¶ 29.

¹⁴⁵ The most salient criticism seems directed at the so-called “Devonia Agreement,” entered into between Berezovsky and his Georgian partner Badri Patarkatsishvili, which was ruled by the judge to be a sham intended only to provide banks with a formal justification for the receipt of \$1.3 billion from Abramovich. *Berezovsky v Abramovich*, *supra* note 20, full judgment, at ¶957).

¹⁴⁶ *Id.*, at ¶56 of the full judgment.

¹⁴⁷ *Id.*, at ¶231 of the full judgment.

¹⁴⁸ *Id.*, at ¶340 of the full judgment.

¹⁴⁹ *Id.*, at ¶422 of the full judgment.

¹⁵⁰ *Berezovsky vs Abramovich: Slozhnosti angliskogo pravosudya*, ZAKON, 10/2012, at 20-32. Some commentators pointed out with irony that in light of such decisions, Russian businessmen were likely to continue spending large amounts of money in English (not Russian) courtrooms. Other commentators expressed dismay at the extent of corruption (and unaccountability) made apparent in the decision. My own private discussions with Russian lawyers indicate that some viewed the decision as a “whitewash” of Abramovich, while others thought that regardless of

the outcome had been in favor of Boris Berezovsky, one can easily speculate that the reaction in Russia would have been considerably more negative.¹⁵¹

The extremely non-transparent asset redistributions of the nineties are central historical events that contributed significantly to modern Russia's governance problems.¹⁵² They have not, to date, been the object of any organized review or revision, politically or legally. It is admittedly unclear whether any such review or revision can ever take place at all for many reasons, including the enduring interconnectedness between Russian political and economic power, the passage of time, and the now highly extra-territorial nature of many of these groups of companies (therefore raising complex issues under international investment law). Adjudication of heavily lawyered private claims in a foreign commercial court on such politically sensitive matters, however, leads to two types of risks: either the decisions are interpreted (in Russia or elsewhere) as a sort of foreign imprimatur on corrupt business practices and the manner in which these assets were obtained (as in *Berezovsky v Abramovich*), or they are viewed in Russia as an attack against the Russian judicial and political system (as in *Cherney v Deripaska*). Either way they are political minefields.

Judicial abstention in such cases might be preferable, for example via a more robust *forum non conveniens* doctrine¹⁵³. These cases illustrate the

the legal reasoning it would have been highly impractical anyways for an English judge to attempt to amend the outcomes of the asset redistributions of the nineties.

¹⁵¹ *Novaya Gazeta*, a liberal newspaper, titled its article "Berezovsky locks horns with Abramovich, and indirectly Putin" (10 October 2011, <http://en.novayagazeta.ru/politics/48927.html>). It wrote that the case was about "the story of how big business was done, fortunes were made and big-time politics was conducted at the turn of the century; the very same period of time that created the condition Russia is in today." The London High Court was invited "to find what is in essence a political answer to this question."

¹⁵² Bernard S. Black, Reinier Kraakman and Anna Tarassova, *Russian Privatization and Corporate Governance: What Went Wrong?* 52 STANFORD L. REV. 1731 (2000), available at SSRN; CHRYSTIA FREELAND, *THE SALE OF THE CENTURY* (2000) (with a second edition in 2005).

¹⁵³ This is not the direction being taken by the Brussels regime (following the curtailing of *forum non conveniens* by *Owusu*, *supra* note 102). However, cases against non-EU defendants are not covered by the Brussels regime and remain governed by national jurisdictional rules (except when they fall within EU exclusive jurisdiction titles such as immovable property, public registers, etc., under Article 24, or in the presence of a jurisdictional agreement in accordance with Article 25). Efforts are under way in some parts of the European institutions to widen the Brussels regime to cases against non-EU defendants and accordingly reduce the place of national jurisdictional rules, but they will probably meet

tension between comity and the individual right of access to justice in commercial matters.¹⁵⁴ They also illustrate the consequences of the current bias in favor of party autonomy (sometimes called the “market paradigm”¹⁵⁵) that underpins private international law today, allowing litigants to select their preferred forum. Ultimately, one might take the more positive view that these lengthy cases provided the Russian public with detailed historical accounts of this complicated period of their history.¹⁵⁶ It is not clear, however, that this should be the role of a foreign judiciary.

5. Conclusion

The poor state of the legal system in the former Soviet countries, combined with the preference of local elites to keep their assets abroad and engage in dispute resolution in Europe, provided very significant work opportunities for foreign lawyers, litigators, and courts. These disputes represented significant proceedings, even at the preliminary or interlocutory stages, which could last for years. By expanding party autonomy and reducing judicial discretion in connection with *forum non conveniens*, at least in Europe, international jurisdictional machinery contributed to the outflow of post-Soviet disputes, but this outsourcing to foreign judges and tribunals of commercial dispute resolution was primarily led by the litigants themselves. It led to the adjudication, outside of Russia, of private disputes between Russian individuals centering on systemically important Russian business dealings, corruption, and asset redistributions.

resistance (*Possibility and terms for applying Brussels I Regulation (Recast) to extra-European disputes*, STUDY FOR THE JURI COMMITTEE, DIRECTORATE GENERAL FOR INTERNAL POLICIES, EUROPEAN PARLIAMENT, 2014, [http://www.europarl.europa.eu/RegData/etudes/etudes/join/2014/493024/IPOL-JURI_ET\(2014\)493024_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/etudes/join/2014/493024/IPOL-JURI_ET(2014)493024_EN.pdf)).

¹⁵⁴ As regards the right to a fair trial under Article 6 of the European Convention on Human Rights, it is not clear that the parties to the Convention had private post-Soviet property disputes in mind, however this is not a matter that I have researched.

¹⁵⁵ Horatia Muir-Watt, *The Role of Conflict of Laws in European Private Law*, in *THE CAMBRIDGE COMPANION TO EUROPEAN UNION PRIVATE LAW* 54-55 (Christian Twigg-Flesner ed., 2010).

¹⁵⁶ As *The Economist* wrote at the time, “Even more than Mr Berezovsky, it is possible to say the Russian taxpayer has emerged as the real loser. The trial produced hours of testimony about state property sold off in the most opaque of ways, with profits from those sales then reinvested to influence domestic politics.” At the other end were the two men’s “British lawyers, the real victors of the saga” (*Unimpressive and inherently unreliable*, *THE ECONOMIST*, 31 August 2012).

IV. Consequences of the outsourcing

To analyze the consequences of the outsourcing one must try to understand its effects on Russian legal development. But first, I propose to examine some of the arguments that have been presented to justify the use of foreign legal infrastructure by economic actors operating in dysfunctional legal systems.

A. *Outsourcing as a rational outcome-maximization*

Part II explained how the Russian laws and statutory patchwork implicitly allowed the outsourcing, or at least failed to constrain it, and that the outsourcing was a response to political risk. Proponents of regulatory competition will make the argument, therefore, that not only was the outsourcing *not* against the law, but it showed sensible business management by Russian economic actors intent on maximizing their own economic outcomes, avoiding dysfunctional institutions, mitigating political risk, and therefore contributing to overall prosperity. This type of argument is grounded in the general belief that regulatory competition between countries creates benefits and that jurisdictional arbitrage must be encouraged. In defense of offshore financial centers, some scholars write that “the rule of law is all too scarce in today’s world and jurisdictions that specialize in providing it to others provide a valuable service that needs to be recognized.”¹⁵⁷ Law is viewed here as a public good which, if not rendered properly by Russian lawmakers and courts to the Russian public, can be rendered to the same Russian public by foreign lawmakers and courts. Jurisdictions providing such services are viewed as exporters not of legal, incorporation, or dispute adjudication services, but of justice and rule of law. A variation on the same idea is that regulatory competition from foreign jurisdictions reduces the control of autocratic governments over domestic economic activity and helps the formation of “rival centers of power.”¹⁵⁸

There are a number of difficulties with this line of argument. It is an expression of general utility-maximization economics that ignores the political economy of law reform and development. The improvement of legal institutions involves complex processes that must surely occur *within* a given country, taking into consideration existing conditions there, whether

¹⁵⁷ Richard Gordon and Andrew P. Morris, *Moving Money: International Financial Flows, Taxes and Money Laundering*, 37 HASTINGS INT’L & COMP. L. REV. 1 (2014). See Conclusion

¹⁵⁸ Andrew P. Morriss, *The Role of Offshore Financial Centers in Regulatory Competition*, September 2008, U ILLINOIS LAW & ECONOMICS RESEARCH PAPER No. LE07-032, available at SSRN, see Section IV.B and Conclusion.

they be legal, economic, social, cultural, political, or historical.¹⁵⁹ The rule of law cannot just be imported, especially not partially and for the wealthiest citizens only; this much is clear from the literature on law and development. The argument on promotion of competition is also contrary to real life experience. In reality, because of the high legal costs involved, access to sophisticated foreign legal infrastructure by economic agents from developing countries is reserved to incumbent economic agents that already hold significant assets. This is certainly the Russian experience: The cost of registering and administering an offshore company may be quite low, but the services of nominee directors and international law firms that are needed to manage transactions in cross-border groups of companies are expensive (more expensive certainly than Russian legal services). The services of foreign lawyers in foreign proceedings are also expensive. The result is that legal outsourcing was more likely to entrench existing positions of privilege rather than promote economic (let alone political) competition. Finally, the systematic use by economic elites of foreign legal entities and courts may have reduced involvement and interest in legal development at home, through a possible “substitution” effect, of which more will be said now.

B. Outsourcing and the substitution theory

In environments with weak legal systems the ability of powerful economic agents to “opt out” and resort to foreign legal infrastructure can have an adverse effect on the home environment. Quantitative research studies seem to indicate that international mechanisms such as investor-to-state arbitration in bilateral investment treaties might in certain circumstances become substitutes for domestic institutions, allowing powerful actors to avoid local judicial institutions, lowering incentives for these local institutions to compete with the global alternatives, and locking developing countries in a “trap of low-quality institutions wherein no political coalition can form to support institutional improvement.”¹⁶⁰

¹⁵⁹ On the superiority of legal systems that were developed internally or transplanted with adaptation to local conditions, see Daniel Berkowitz, Katharina Pistor, and Jean-Francois Richard, *Economic Development, Legality and the Transplant Effect*, 47 EUROPEAN ECONOMIC REVIEW 165 (2003), with an earlier version (1999) available at SSRN; CURTIS J. MILHAUPT AND KATHARINA PISTOR, *LAW & CAPITALISM*, Chapter 10 and p. 211 (2009).

¹⁶⁰ Tom Ginsburg, *International Substitutes for Domestic Institutions: Bilateral Investment Treaties and Governance*, 25 INT’L REV. OF L. & ECON. 107 (2005), available at SSRN. This is a topic on which there does not appear to be any academic consensus, see for example a critique by Paul Stephan, *International Investment Law and Municipal Laws: Substitutes or Complements?* CAPITAL MARKETS LAW REVIEW, forthcoming (2014). On the parallel topic of whether

Economists have previously highlighted the tendency, in unequal societies, for rich property holders to favor low quality governance mechanisms—including specifically Russia.¹⁶¹ The substitution theory suggests the possibility of adverse institutional effects resulting from the extensive provision (and use) of exogenous legal infrastructure. Empirically at least, this hypothesis seems in direct resonance with the Russian experience over the last two decades. The Russian elites who moved large parts of their businesses abroad arguably had less skin in the game of Russian law and judicial improvement than small businesses or ordinary Russian citizens for whom moving abroad or litigating in foreign courts or arbitration venues was not a realistic option. If these elites had had to deal with Russian institutions for their important business disputes, they might have been more incentivized to engage politically to increase the chances of obtaining dispute adjudication that would be more transparent, predictable, and impartial. This new constituency could have included the “oligarchs” and also perhaps the growing class of upper middle-class entrepreneurs and professionals whose voices became audible, for a short while at least, in the waves of popular protest that took place in 2011 and 2012. Instead of brutal Yukos-type policies favored by the Putin government, an additional route to this virtuous dynamic could perhaps have involved less incoming supply of foreign law and dispute resolution, for example through a more restrictive approach to party autonomy and more robust *forum non conveniens* doctrines in important foreign venues.

Against this theory, it may be possible to argue (as some do) that in the Russian context, the substitution theory is too critical of the roles played by the foreign legal community and Russian private sector, in turn underestimating the responsibility throughout the last twenty years of deeply dysfunctional Russian public authorities (or of groups having gained control of those authorities).¹⁶² The facts on the ground remain, however, as described in Part I. The extent of the legal outsourcing meant that the growing number of competent Russian practicing lawyers and judges were not as empowered as they might have been. The absence of a sufficient stream of large-scale contentious commercial work in the Russian courts meant that Russian judges did not benefit from the kind of professional

BITs have a positive effect on foreign investment, see Jason Webb Yackee, *Do Bilateral Investment Treaties Promote Foreign Direct Investment? Some Hints from Alternative Evidence*, 51 VA. J. INT’L L. 397 (2010-2011).

¹⁶¹ Konstantin Sonin, *Why the Rich May Favor Poor Protection of Property Rights*, 31 JOURNAL OF COMP. ECON. 715 (2003), available at SSRN, and other sources cited by him.

¹⁶² According to this view, foreign or exogenous legal infrastructure can serve as “complements” to domestic institutions rather than “substitutes” (Paul Stephan, *supra* note 160).

interaction and cross-fertilization that exists in most developed legal environments where judges and lawyers spend significant time and effort arguing points of law or fact and in doing so increase their collective body of knowledge and experience. Without this kind of systemic daily interaction with experienced commercial lawyers Russian judges remained as they are now, insufficiently familiar with modern business practices. They continued on their legacy path of judicial isolation, their work remaining insufficiently coordinated with that of international practitioners, foreign courts and foreign tribunals, as will now be seen in the next paragraph.

C. The Russian backlash

Policies are being implemented since Vladimir Putin's return to presidential power in 2012 that aim to reduce what is now clearly viewed by the top executive as excessive reliance on foreign legal infrastructure. They involve a defensive approach to the jurisdiction of the Russian courts, the re-regulation of the Russian legal profession, a large-scale overhaul of the Civil Code, and, finally, policies of financial and corporate "de-offshorization."

1. Jurisdiction of the Russian courts and reform of the legal profession

In marked contrast with the business elites and commercial law firms, in the last two decades the Russian courts (including the commercial arbitrazh courts) have operated in judicial isolation involving limited contact with the outside world. In technical terms this judicial isolation manifested itself in two ways: first, in the non-recognition of most foreign judgments, and second, in a negative attitude towards arbitration. The traditional position of the Russian courts has always been that in the absence of a specific treaty (of which there are very few), foreign judgments could not be recognized or enforced¹⁶³. Reciprocity was not a sufficient basis¹⁶⁴. This means that for one, the important English court decisions discussed in Part III were probably not capable of recognition or enforcement in Russia proper despite centering on major companies and themes for the Russian economy (and despite the significant Russian law analysis that is found in some of these decisions). There is an increasing debate on this topic now;¹⁶⁵ but still, the default position remains non-

¹⁶³ Article 409.1 of the Civil Procedural Code and Article 241.1 of the Arbitrazh Procedural Code.

¹⁶⁴ Vorobieva, *supra* note 55, ¶406.

¹⁶⁵ The position regarding reciprocity is quite murky. Certain specific laws such as the bankruptcy law specifically allow for reciprocity. Furthermore there

recognition and non-enforcement of foreign judgments, arguably one of the more significant holdovers from Soviet law.

The other illustration of the tendency to judicial isolation involves arbitration. Russia is a party to the 1958 New York Convention and must therefore in principle recognize and enforce awards—save for the exceptions set out at Article V of the Convention which were transcribed as Article 244 of the Arbitrazh Procedural Code (APC). For years, however, the arbitrazh courts adopted an extensive and often unpredictable interpretation of public policy, leading to a significant number of awards being set aside¹⁶⁶. In addition to the traditionally wide interpretation of public policy, a more recent line of argument challenges the scope of arbitrability of as well (whether arbitration takes place in Russia or abroad). “Corporate disputes” are a salient example. According to the APC “corporate disputes” were non-arbitrable, however this expression had not been interpreted to include contracts for sales of shares. Reversing this position, the Supreme Arbitrazh Court ruled in 2012 that a price dispute under a share purchase agreement was, in effect, a “corporate dispute” and therefore excluded from the right to arbitrate (the contract had provided for arbitration at the International Commercial Arbitration Court in Moscow).¹⁶⁷ The claimant Maximov filed an unsuccessful challenge before the Russian Constitutional Court; he then embarked on international enforcement strategies, *inter alia* winning a decision by the Paris Tribunal

seems to have been some movement in the position of some arbitrazh courts, see for example Supreme Arbitrazh Court decision No. 12688/09, 7 December 2009 (criticized by Vorobieva) and the decisions cited by the author at *Russian Court Recognizes Northern Ireland Judgement in the Absence of Special Treaty*, 5 November 2013, CIS ARBITRATION FORUM, <http://cisarbitration.com/2013/11/05/russian-court-recognised-northern-ireland-judgment-in-the-absence-of-special-treaty/>. The difficulty is the absence of consistency or predictability. For a discussion (between two Russian academics) of this question in an English court, see *Baturina v Chistyakov* [2013] EWHC 3537 (Comm) (14 November 2013), ¶¶134-140.

¹⁶⁶ Early in 2013, the presidium of the Supreme Arbitrazh Court published a letter summarizing 12 rulings on recognition and enforcement of foreign arbitral awards with the aim of clarifying its approach to the public policy exception (Information letter No. 156 of 26 February 2013, www.clj.ru/publications/12/4354). The main difficulty with many of the underlying judgments, however, is the absence of sufficient detail on the exact circumstances of each case.

¹⁶⁷ Supreme Arbitrazh Court Case No. A40-35844/2011-69-311, 30 January 2012.

de Grande Instance to recognize and enforce the initial ICAC award despite its annulment by the courts of the forum.¹⁶⁸

In 2012, “judicial sovereignty” (*sudebny suverenitet*) became a popular theme in the public rhetoric of senior judges and politicians. Speaking at a legal forum in Saint Petersburg, then President Dmitry Medvedev complained about “unfair competition” from foreign legal systems.¹⁶⁹ These comments were fuelled by what was perceived as excessive international criticism of the Russian legal system, for example, in decisions such as *Cherney v Deripaska*, by charges of collusion between foreign arbitration venues and foreign courts (presumably also in the U.K.) and by anti-suit injunctions such as one that was issued by the London High Court in a case involving the Russian company Russian Machines (a part of the Deripaska group).¹⁷⁰ The reason this injunction was so controversial was that it was issued against a company that was not a party to an English jurisdictional agreement and also because as a result of the injunction the Russian companies preferred to follow the English injunction and not appear at Moscow hearings that they had themselves initiated.¹⁷¹ The injunction was admittedly unusual, English anti-suit injunctions against Russian parties

¹⁶⁸ On the Paris judgment see the Kluwer arbitration blog at <http://kluwerarbitrationblog.com/blog/2012/06/26/enforcement-of-arbitral-awards-that-have-been-set-aside-at-the-seat-the-consistently-inconsistent-approach-across-europe/>. The other side in the *Maximov* dispute was NLMK (Novolipetsk Steel), a metallurgical group of companies, whose beneficial owner is Vladimir Lisin. NLMK maintains a special webpage explaining their views on the legal underpinnings of the case at <http://maxi-group.nlmk.ru/eng/>.

¹⁶⁹ *Deklaratsya o sudebnom suverenitete*, KOMMERSANT, 18 May 2012, <http://www.kommersant.ru/doc/1935924>; *Russia Slams Foreign Courts for “Unfair Competition”*, EURASIAN LAW, 18 May 2012, <http://eurasian-law-breaking-news.blogspot.com/2012/05/russia-slams-foreign-courts-for-unfair.html>;

¹⁷⁰ *BNP Paribas SA v Open Joint Stock Company Russian Machines & Anor* [2011] EWHC 308 (Comm) (24 November 2011); *Ingosstrakh Investments v BNP Paribas SA* [2012] EWCA Civ 644 (24 May 2012).

¹⁷¹ Russian company Russian Machines had entered into a guarantee in favor of the bank BNP Paribas to secure the obligations of one of its affiliates. The guarantee was governed by English law and contained an English arbitration clause. The bank unsuccessfully attempted to enforce the guarantee against Russian Machines, whereupon a (smallish) shareholder of that company filed proceedings in the Moscow City arbitrazh court seeking to invalidate the guarantee for lack of corporate approvals. On application by the bank, the London High Court issued an anti-suit injunction against the Russian shareholder, considering that it had colluded with the Russian guarantor to subvert the English arbitration clause and that such conduct was vexatious and unconscionable. As a result of the injunction, the Russian shareholder (i.e., the claimant in the Russian proceedings) did not attend a Moscow hearing.

usually being issued when they had, in fact, signed up to an English jurisdictional agreement.¹⁷² Whatever the detailed legal reasoning, however, the wider effects of the injunction were keenly felt in Moscow. The then chairman of the Supreme Arbitrazh Court threatened retaliatory measures that could include the blacklisting of foreign lawyers and measures against Russian offices of foreign law firms.¹⁷³

Finally, a word on the efforts to re-regulate the Russian legal profession. A draft law is under preparation that may merge advocates and *yuristy* into a single profession. All commercial law firms may become required to practice as advocates and all commercial lawyers may have to sit the Russian bar exam. The status of foreign practitioners may also be placed into question.¹⁷⁴ Seen in the wider context of Russian legal development, the re-regulation of legal services seems reasonable.¹⁷⁵ As always, however, the success of the reform will depend on whether it can be prepared, rolled out and enforced in a suitably non-discretionary and transparent manner.¹⁷⁶

¹⁷² For example, AES Ust-Kamenogorsk Hydropower Plant LLP v Ust-Kamenogorsk Hydropower Plant JSC [2011] EWCA Civ 647 (27 May 2011) or Russian Commercial Bank (Cyprus) Ltd v Khoroshilov [2011] EWHC 1721 (5 July 2011). *BNP Paribas v Russian Machines* was described somewhat tongue in cheek by English commentators (*Practical Law*) as “an interesting and relatively unusual example of anti-suit relief being granted against a non-party to the arbitration clause” (*Collusive foreign proceedings were vexatious and oppressive (Court of Appeal)*), <http://uk.practicallaw.com/7-519-6885#null> (accessed on 26 November 2013).

¹⁷³ *Russian law and unfair competition*, Sergey Feklyunin, RAPSINews 25 May 2012, http://rapsinews.com/judicial_analyst/20120525/263259093.html.

¹⁷⁴ See government resolution No. 1453-p of 16 August 2013, available at <http://minjust.ru/ru/node/5458> (press release dated 23 August 2013); Sergey Pepelaev, *Rinok pravovikh uslug: Kontury reformy*, NOVAYA ADVOKTSKAYA GAZETA, 13/2013 (150), <http://www.advgazeta.ru/arch/150/1117>.

¹⁷⁵ Interview with Yevgeny Semenyako, RUSSIAN LAW ONLINE, 29 November 2010, <http://www.russianlawonline.com/content/interview-yevgeny-semenyako>; Maxim Odintsov, *Sud da delo*, KOMMERSANT, 13 September 2010, <http://www.kommersant.ru/doc/1500579>; Genry Reznik, *Ne kardinalno reformirovat', a prosto uregulirovat'*, ZAKON, 9/2012, p. 91-93; Alexander Latyev, *Ogranichennaya advokatskaya monopoliya ili otnositelnaya svoboda sudebnogo predstavilstva*, ZAKON, 9/2012, p. 94-104.

¹⁷⁶ To be complete one must also mention the dissolution of the Supreme Arbitrazh Court as an autonomous higher court and its merger with the Supreme Civil Court (which handles civil and criminal affairs). The reasons for this reform, which began in the fall of 2013, were still being debated at the time of publishing this article, as were its practical implications on actual decision-making by the local

2. Overhaul of the Civil Code

Part II elaborated on why Russian contract law was long viewed as insufficiently robust to support significant transactions. This now widely shared view gave rise to an extensive effort to overhaul key provisions of the Civil Code. This enormous effort is still under way; several laws were adopted beginning in April 2012, followed by a series of laws in December 2012 and throughout 2013. Further laws are expected in 2014.¹⁷⁷ The changes that are proposed are very ambitious. They include concepts such as good faith performance and “evasion of law,” which had been discussed in earlier decades but were never adopted (see Part II), thereby introducing the possibility of “substance over form” type decision making by judges. The “incorporation” theory is also under question.¹⁷⁸ The changes introduce

and regional arbitrazh courts. A package of laws was adopted in this respect in March 2014 (*Putin ster iz zakonodatelstva upaminanya o VAS i likvidiroval DSP*, <http://pravo.ru/news/view/102764/>).

¹⁷⁷ The overhaul of the Civil Code was first decided back in 2008 (Presidential Decree Nr. 1108 of 18 July 2008 “On the improvement of the Civil Code of the Russian Federation”, following which a special committee was formed and produced a concept paper in 2009). The first complete draft of the proposed amendments was adopted by the Duma in first reading on 27 April 2012 (draft law No.47538-6 “On Amendments to the first, second, third and fourth parts of the Civil Code and other Legislative Acts of the Russian Federation”); the draft was then broken down into several series which are being discussed and adopted in stages (Federal Law No. 302-FZ of 30 December 2012, Federal Law No. 100-FZ of 7 May 2013, Federal Law No. 142-FZ of 2 July 2013, Federal Law No. 260-FZ of 30 September 2013, Federal Law No. 367-FZ of 21 December 2013). For a selection of Russian academic commentary, see in KHOZYAISTVO I PRAVO: V. Vitriyansky, *Obshe polozhenya ob obyazatelevakh v uslovyakh reformirovaniya grazhdanskovo zakonodatelstva* (3/2012), *Obshe polozhenya o dogovore v uslovyakh reformirovaniya grazhdanskovo zakonodatelstva* (4/2012), I. Shytkina, *Voprosi korporativnogo prava v proekte federalnogo zakona o vneseniy izmeneniy v Grazhdanskiy kodeks RF* (6/2012), A. Erdelevsky on changes to the first two parts (9/2013) and A. Asaskov on changes to the part on private international law (2/2014); in ZAKONODATELSTVO: N. Kozlova and S. Filippova, *Grazhdansko-pravovye sposoby zashity prav aktsionerov v svete reformirovaniya grazhdanskovo zakonodatelstva* (2/2013); in BULLETIN (VESTNIK) OF THE SUPREME ARBITRAZH COURT: G. Osipov and M. Tolstukhin, *Reforma Grazhdanskogo kodeksa RF i oborot nedvizhimosti* (1/2013); Dmitry Stepanov, *Dispozitivnost’ norm dogovornogo prava. K kontseptsii reform obshikh polozheniy Grazhdanskogo kodeksa RF a dogovorakh* (5/2013).

¹⁷⁸ See changes to Article 1202 and the decision of the Presidium of the Supreme Arbitrazh Court No. 14828/12 of 26 March 2013, available on www.arbitr.ru, in relation to offshore corporate structures, as well as a draft regulation by the same court; D. Lomankin, *Kontseptsya snyatya korporativnogo pokrova: realizatsya eyo osnovnikh polozheniy v deistvuyushem zakonodatelstve i*

new institutions that are viewed as useful for domestic transactions: for example escrow agreements, put and call options, conditions precedent depending from contractual parties, and provisions on warranties and indemnities. These reforms are ambitious, but they are arguably late. Their “lateness,” of course, is the result of “home-grown” development as opposed to mere transplants from foreign systems. Ultimately, their success will depend on whether parallel improvements in judicial decision making and enforcement are also achieved.¹⁷⁹

3. “De-offshorization”

In his last two annual addresses to the joint houses of Parliament in December 2012 and 2013, Vladimir Putin exhorted Russian businessmen to become “patriotic” in their business practices and to “de-offshorize” their businesses.¹⁸⁰ This “de-offshorization” campaign has, for now, translated into three main policy initiatives: first, laws aiming to reduce corruption by prohibiting Russian civil servants from holding bank accounts or assets abroad;¹⁸¹ second, an overhaul of currency controls and anti-money laundering legislation *inter alia* expanding obligations to disclose beneficial ownership, including at the top of foreign or corporate or trust structures;¹⁸² and thirdly, tax reforms aiming to introduce controlled foreign corporation legislation pursuant to which Russian beneficial owners will become taxed

proekte izmeneniyi Grazhdanskogo kodeksa RF, BULLETIN (*VESTNIK*) OF THE SUPREME ARBITRAZH COURT (9/2012).

¹⁷⁹ The dissolution of the Supreme Arbitrazh Court may be an ominous development (see *supra* note 174).

¹⁸⁰ Presidential Address to the Federal Assembly, 12 December 2012 (<http://eng.kremlin.ru/transcripts/4739>) and 12 December 2013 (<http://eng.kremlin.ru/transcripts/6402>).

¹⁸¹ Federal Law No. 79-FZ of 19 May 2013 “On the prohibition for certain categories of persons to open and maintain accounts (deposits), hold cash deposits and values in foreign banks located outside of Russia, own and/or use foreign financial instruments.” This law also required any “trust” type arrangements for the holding of foreign assets to be terminated. An administrative instrument (in the form of an unpublished November 2011 presidential instruction) already required the top management of all state-owned companies to disclose their private assets (including shares owned in other companies). There were empirical indications that enforcement of this (unpublished) instruction was on the rise in 2012/2013.

¹⁸² Federal Law No. 194-FZ of 12 November 2012 “On amendments to Article 3.5 and 15.25 of the Administrative Offences Code”; Federal Law No. 134-FZ of 28 June 2013 “On amendments to several legislative acts of the Russian Federation in connection with the prevention of illegal financial operations.”

in Russia on income received by foreign companies that are under their control (in draft form at the time of publication¹⁸³).

It is far too early to judge the effect of these cumulated policies or the manner in which they will be enforced in practice. If law enforcement bodies are empowered without a significant improvement in the functioning of the bureaucracy and judiciary, as has often been the case in Russia, the net effect could well be to further feed the legal outsourcing rather than curb it. Legal outsourcing has a circular quality: it feeds on the failures of a legal system and institutions that are themselves locked in a low-quality trap and tempted to resort to brutal retaliatory methods rather than devise and implement long-term multi-institutional responses. The geopolitical tensions resulting from the crisis in Ukraine are unlikely to be helpful: at the time of publication, public statistics indicated that the amount of capital leaving Russia had increased significantly (the opposite of what Russian leadership would wish to achieve with its reforms). What is clear, at any rate, is that regulatory competition and legal outsourcing are on the radar screen of the Russian government and law enforcement bodies, meaning that there is increased political risk for Russian economic actors continuing to engage in them.

V. Conclusions

Over the last twenty years Russian economic elites made extensive use of foreign legal entities to which they transferred significant portions of their assets and businesses. For the resolution of their economic disputes, they preferred foreign commercial courts and arbitration venues. This legal outsourcing, which began in the early nineties, was the result of the Russian elites' desire to avoid Russian jurisdiction, mitigate political risk and obtain transnational asset protection. It was enabled by a robust supply of foreign law and legal infrastructure. The Russian political power structures largely allowed the outsourcing to occur—although this attitude may perhaps be changing.

The Russian outsourcing experience sheds light in several areas. First, it sheds new light on the field of law and development. This field seeks to understand the interplay between economic growth and legal and institutional reform in countries at early or transitional stages of economic development. Russia is now a middle-income country, the 8th or 9th largest economy in the world in nominal terms. In 2001 it was included in the BRIC group of countries. Its growth record in the years after the 2008 financial crisis, however, has been quite poor. It also ranks poorly in terms

¹⁸³ A draft law was produced by the Ministry of Finance on 18 March 2014 proposing a series of amendments to the Tax Code.

of governance and quality of legal institutions. The creation in Russia of property rights and a new legal system, by way of privatization in the mid-nineties followed by legal reforms, was the object of significant Western scholarly study up until the early 2000s, but after that academic interest dwindled somewhat.

Today, Russian outsourcing shows how the failure by Russian law to achieve satisfactory protection of property rights and contract enforcement co-existed with a massive switch to foreign legal infrastructure in order to obtain these very mechanisms. It confirms the central quest for protection of property rights and contract enforcement by owners of capital. It seems to raise several questions for scholars who seek to model the effectiveness of domestic legal institutions.¹⁸⁴ Domestic institutions are usually studied in isolation, i.e., in the domestic context, without first modelizing the effects of the ease with which economic actors are able to switch to the legal infrastructure of other countries instead. The openness of private international law now allows economic actors to be nimble transnational users of all kinds of foreign legal systems; it might be interesting to modelize this ability to move around. It is true that the ability to access foreign infrastructure is costly and therefore reserved to the wealthiest economic actors. However, when economies are highly concentrated, as is the case in Russia, this ability to move around simply cannot be ignored. Another question that is raised, for middle-income economies with dysfunctional legal systems, is whether the switch to foreign legal infrastructure may in fact be more relevant than the traditional forms of legal substitutes that have usually been examined by the literature, e.g., “informal” or “extra-legal” enforcement mechanisms.¹⁸⁵

Second, the Russian outsourcing sheds light on the effect of timing and alignment of law reforms. Statutes like the Civil Code or the Tax Code need reforming, but these reforms may be occurring too late, at a time when the largest Russian economic actors are already significantly extra-territorial. The same might be said for certain administrative reforms that were adopted in 2008/2009. Successful law reform requires a consistent, multi-layered approach to reform in all of the areas of law that impact economic actors: contract law and corporate law, but also tax law, private

¹⁸⁴ This brings to mind the “legal origin theory” that purports to explain economic growth by the origin of countries’ legal systems (classified in large brushes between common law, French civil law, and German civil law). This theory has been challenged but remains influential. The original paper is Rafael La Porta, Florencio Lopez-de-Silvanes, Andrei Shleifer, and Robert W. Vishny, *Law and Finance*, 106 J. OF POLIT. ECON. 1113 (1998).

¹⁸⁵ Timothy Frye and Ekaterina Zhuravskaya, *Rackets, Regulation and the Rule of Law* (March 2001), CEPR DISCUSSION PAPER No. 2716, available at SSRN.

international law, and administrative laws such as foreign investment and anti-monopoly controls. Rules in these areas must be properly aligned, in order to achieve a consistent set of signals sent to economic actors, and must be combined with predictable and reasonable enforcement.

The Russian outsourcing shows the consequences when these various disciplines are non-aligned, or incorrectly aligned: in light of the underdevelopment of contract law and corporate law, areas such as tax law, private international law and administrative laws should perhaps have been more restrictive (and privatizations should have been slower). In the Russian context, of course, the persistence of political risk and continued weakness of institutions tasked with interpretation and enforcement of the laws leads to skepticism as to the degree of relevance of the substantive content of any laws. To that skepticism, one can respond that Yukos occurred in 2003/2004, i.e., at a time when significant economic interests had already long fled the jurisdiction. The narrative that “much was already lost” by the end of the nineties is in fact supported by some of the legal data (that this narrative was politically instrumentalized by the current leadership while at the same time allowing the outsourcing to continue for more than a decade is a different theme, that of state capture during the entire post-Soviet period). The question now is what reforms (if any) can be implemented to reduce or reverse the outsourcing process, without creating additional political risk. During the nineties some scholars thought that legal reforms should have preceded (and not followed) privatization.¹⁸⁶ There is no rulebook on how these things must be done, but it is clear that reform sequencing matters a great deal.

Third, the Russian outsourcing sheds light on the role that foreign lawyers, foreign courts and foreign legal infrastructure play in global regulatory competition. Based on empirical observation at least, Russian legal outsourcing has had institutional consequences: it contributed to continued weakness of the local courts, did not enable the formation of a sufficiently dynamic feed-back loop between lawmakers and business elites as to domestic institutions that were needed to support economic activity (contracts, corporate law, etc.) and arguably lowered incentives for business elites to become involved in domestic institutional development. Yet at the same time it provided substantial economic opportunities to many thousands of foreign professionals who (very naturally) seized those opportunities. The role of foreign lawyers and law firms in large emerging economies may be greater when the domestic legal profession is both

¹⁸⁶ Katharina Pistor, *Company Law and Corporate Governance*, in *THE RULE OF LAW AND ECONOMIC REFORM IN RUSSIA* (Jeffrey D. Sachs and Katharina Pistor, eds., 1997), at 176; for critics of the reforms conducted in the nineties, see the references at *supra* note 68.

nascent and unregulated, but the longer term persistent role of foreign lawyers in itself, in any country, may not be conducive to improvement of the domestic legal system. This includes corporate services exported by specialized jurisdictions and dispute adjudication in foreign courts and arbitration venues.

By placing the emphasis on corporate incorporation theory, party autonomy and individual rights of access to justice, the current European rules of private international law do not address systemic risks that may be created in third countries with weak legal systems. In a world of increasing country specialization, certain countries can justifiably regard legal services and dispute adjudication as exports of high value added services, but there are also systemic effects in third countries. The legal professionals themselves cannot be asked to voluntarily relinquish these work opportunities; this type of transnational ordering of legal services has to be addressed at a policy level, at a domestic or intergovernmental level. A first step towards recognizing and addressing this problem in the EU might involve a more robust doctrine of *forum non conveniens* and a nuanced approach to party autonomy and individual rights of access to justice when dealing with extra-European private property or commercial disputes (this assumes, of course, that some sort of consensus on such matters can be reached within the EU, which is far from clear).

Finally, the Russian legal outsourcing raises the question whether legal systems that developed in the European context can operate and properly adjudicate situations arising in third countries in which governance and institutions operate along different sets of values. European legal systems developed over centuries and rest on a number of values that are embedded into the law. These values imply a certain number of behavioral assumptions that are not formulated as such but are ever present (for example the concept of an individual acting “reasonably,” or being “truthful,” or acting in a certain way because he expects to achieve a certain result, in “good conscience” or “good faith”). We may assume that these behavioral assumptions are universal and “hard-wired” into all human beings regardless of their culture of origin, but this is an assumption that perhaps should not be taken for granted;¹⁸⁷ it should be formulated and if possible backed up by scientific and empirical reasoning. This is not to say that values cannot converge, or that individuals are unreconstructed products of their environment and cannot change, but fundamentally one cannot escape the intuition that institutions that aim to deliver justice (or

¹⁸⁷ For a discussion on the behavioral assumptions embedded in classical economics, see DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE, (Chapter 3: *The behavioral assumptions in a theory of institutions*) (1990).

more prosaically allocations of property rights that are perceived as fair) must develop organically and cannot be transported or transplanted. Attempts by successive law and development movements to export Western-centric legal models in different guises were severely criticized.¹⁸⁸ However, private international law is also built on the implicit idea that nationally developed legal systems and institutions are able to deliver equivalent outcomes in other countries or environments, regardless of local conditions. This idea should perhaps be looked at more critically, at least when dealing with matters or cases that unfold in peculiar historical circumstances or in countries with a different cultural profile.

¹⁸⁸ David Trubek, Marc Galanter, *Scholars in Self-Estrangement: Some Reflections on the Crisis in Law and Development Studies in the United States*, 1974 WIS. L. REV. 1062 (1974); *Law and Development Movement*, World Bank website, <http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTLAWJUSTINST/0,,contentMDK:23103515~menuPK:1989584~pagePK:210058~piPK:210062~theSitePK:1974062~isCURL:Y,00.html> (1995); Brian Tamanaha, *The Primacy of Society and the Failures of Law and Development*, 44 CORNELL INT'L L.J. 209 (2011).

