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High Commercial Court tramples international agreements

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To interpret corporate law as prohibiting agreements with foreign choice of law is a dangerous intrusion on the freedom to contract and endangers investment.

A quiet but dangerous legal revolution took place in Ukraine just before the new year.

In a resolution that went surprisingly unnoticed, the Ukrainian High Commercial Court surreptitiously decided that Ukraine is too unique to abide by the international treaties it signed.

Through the Court's decision, Ukraine effectively seceded from the New York Convention on the Recognition and Enforcement of Arbitration Awards, insofar as corporate relationships are concerned.

The Court took the view that any agreements among shareholders of Ukrainian joint stock companies containing non-Ukrainian choice of law provisions or international arbitration clauses are null and void.

While the Court's recommendations are not technically binding, they are a persuasive authority and may be relied upon by any lower court.

Aside from throwing into legal limbo existing corporate relationships and being an affront to Ukraine's international obligations, these recommendations contradict basic principles of Ukrainian law.

The New York Convention, which was signed by 89 countries including Ukraine, requires courts to recognize decisions of international commercial arbitration tribunals, save for a number of limited exceptions.

There is no specific exception for contractual agreements among shareholders. In fact, given the dismal state of the Ukrainian legal system and its inability to deal with complex commercial conflicts, international arbitration and foreign choice of law provisions were perhaps the only means for foreign investors to assure that any potential disputes would be resolved by an impartial and experienced panel.

After the Dec. 28 resolution, this is no longer the case.

The High Commercial Court inexplicably decided that foreign choice of law provisions and arbitration clauses in shareholder agreements contravene the public policy of Ukraine.

The Court failed to explain what exactly such a public policy would be.

Why should shareholders not be allowed to freely decide their choice of law or the particular dispute resolution body they trust?

One can only surmise that this is a protectionist policy devised to “protect” Ukrainian shareholders against greedy foreign investors, who come to Ukraine armed to the teeth with tasselloafed Western lawyers, and try to implement rules of the game supposedly unknown to backward and uninformed Ukrainians.

While the New York Convention does contain a so-called “public policy” exception to the recognition of awards, it has been narrowly construed by the courts of signatory countries to give proper deference to the parties’ agreement to arbitrate.

For example, in France and Portugal, legislation provides that their public policy is “international public policy.”

A similar approach has been taken by the courts of Italy, Switzerland, Germany and Sweden.

In the United States, Judge Joseph Smith in *Parsons & Whittemore* (Second Circuit Court of Appeals, 1974) held that enforcement of a foreign arbitral award may be denied on public policy grounds “only where enforcement would violate the forum state’s most basic notions of morality and justice.”

Generally, courts apply the public policy exception when such substantive fundamental principles as the principle of good faith and prohibition of abuse of rights (especially in civil law countries) are at issue.

Other examples that are cited by courts and commentators include: *pacta sunt servanda* (arguably the oldest principle of international law which means “agreements must be kept”), the prohibition against uncompensated expropriation and prohibitions against racial, ethnic and religious discrimination.

In some instances, public policy also includes the prohibition against punitive damages and antitrust violations.

Fundamental principles also include prohibition against activities that are against good morals, such as piracy, terrorism, genocide, slavery, smuggling, drug trafficking, and pedophilia.

Not surprisingly, corporate law is not on this list.

Furthermore, there is little indication that the High Commercial Court did an analysis of the international norms and principles which define the scope of “public policy.”

The resolution is tellingly devoid of any explanation or rationale for the Court’s view.

Not only does the resolution contradict international law, but it also runs afoul of basic principles of Ukrainian domestic law.

The Ukrainian Civil Code proclaims freedom of contract.

Parties are free to enter into agreements unless specifically prohibited by law.

Nowhere does Ukrainian law provide that parties cannot use foreign law to regulate their relationships as corporate shareholders or to enter into agreements to arbitrate, instead of bringing a lawsuit.

To interpret corporate law as prohibiting agreements with foreign choice of law is a dangerous intrusion on the freedom to contract.

The High Commercial Court should urgently revise its recommendations which put Ukraine in the unique situation of a country where arbitration decisions cannot be enforced and where corporate shareholders are not permitted to contract on the specifics of their relationships.

The danger here is not only that Ukraine will isolate itself from the international legal community, but also that foreign courts, when presented with arbitration awards issued by Ukrainian tribunals, will decline to enforce them because Ukraine does not enforce their awards reciprocally.

This dangerous state of affairs needs to be resolved now to avoid Ukraine becoming a mockery of the international legal system.

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