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Abstract

The Russian arbitrazh courts are charged with resolving economic disputes among legal entities. The capacity of these courts to exercise this function in a meaningful fashion hinges in large part on an ability to implement the decisions reached. Going to court is rarely the easiest or the least costly method of resolving disputes, and if its decisions cannot be enforced, then economic actors will question the wisdom of using the courts. Trust in the courts is quite delicate, and can be easily undermined.

Difficulties in implementing their decisions is consistently identified by Russian arbitrazh judges as the most serious problem facing these courts. On one level, the problem is caused by institutional inadequacies. The low-level officials charged with implementing the decisions (in cases where the defendant does not voluntarily comply) are not part of the hierarchy of the arbitrazh courts, but are an arm of the courts of general jurisdiction. Moreover, the procedure itself is cumbersome and puts most of the burden on the private party seeking to recover damages. But on a deeper level, the problem is a lack of respect for these courts. No court can survive if all of its decisions have to be enforced coercively. Courts depend on the good will of the litigants. Its absence in the Russian context is troubling, because the problem feeds on itself. In other words, if the courts are perceived as being impotent, then economic actors will shy away from them, which only reinforces their lack of power and legitimacy.

I. Overview

The purpose of a court is to resolve disputes. The resulting decisions mean little, however, if not implemented. The capacity to implement its decisions is critical to the functioning of any judicial system. It is essential not only with respect to ordinary citizens but also when decisions go against the state or other powerful individuals or entities (regardless of whether the source of the power is political or economic). (Hendley, 1996) Absent such a capacity, submitting disputes to a court would seem to be a waste of time and energy. From an institutional point of view, the absence of such a capacity would create a vacuum which might well be filled by private agencies. After all, the desire for stability in economic relations, i.e., for enforceable contracts, is universal. If the state-sponsored legal institutions prove incapable of fulfilling this need, then economic actors will look elsewhere.

In Russia, economic disputes between legal entities are within the jurisdiction of the arbitrazh courts. Without exception, arbitrazh court judges identify implementation of their decisions as the single biggest problem facing the court. The chairman of the Higher Arbitrazh Court, V.F. Yakovlev, has gone on the record with strong criticisms of the courts' capacity to implement their decisions. (Vasil’eva, 1996) An enforcement capacity is a fundamental feature of any judicial
institution, and the arbitrazh courts fall short. This is a relatively new problem. During the Soviet period, all enterprises were state owned, which meant that damages awarded by gosarbitrazh (the institutional predecessor to the present-day arbitrazh courts) amounted to transfers from one pocket of the state to another. Under these circumstances, enforcement was virtually automatic. Implementing arbitrazh court decisions became increasingly more difficult as enterprises had to answer for their financial well-being and could no longer count on the state to bail them out. Not surprisingly, as money came to matter, enterprises were less willing to part with it. Also contributing to the difficulty in enforcing judgments were the rapidly changing regulations governing bank accounts. In the Soviet era, an enterprise could only have one bank account (with subaccounts for nalichnye and beznalichnye funds). In the early 1990s, the rules changed and, for a time, enterprises were able to hide money by opening new accounts. In time, this loophole closed, but new ones grew up in its wake. Now many enterprises operate on a cash basis, which makes it extremely difficult to assess their financial condition. The political difficulties associated with bankruptcy result in enterprises hanging onto life long after their resources have been depleted.

II. Implementing Decisions in Arbitrazh Courts

The APK outlines the procedure by which judgments of the arbitrazh court should be implemented. The process is best illustrated through a hypothetical situation. Assume the petitioner wins and is awarded damages. The decision takes legal effect one month after its issuance. (art. 135, APK) During this month, the parties have the right to file an appeal, which would stay the trial court decision. Assuming no appeal, the defendant is legally obligated to comply with the decision once it takes legal force. Ideally, the defendant should pay the damages on the basis of the decision, without the court taking any further action. If the defendant fails to pay, then the petitioner can go back to the arbitrazh judge and request an enforcement order (ispolnitel'nyi list). The APK obligates the judge to take all steps necessary to ensure the implementation of his/her decisions. (art. 136, APK) In effect, an ispolnitel'nyi list is an order from the court to the bank to pay the judgment from the defendant's account. (art. 198, APK; Yakovlev and Iukov, 1995, pp. 406-14) If the defendant has money in the bank, then the judgment will be paid. If the account is empty, the bank will so notify the petitioner. The next step is for the petitioner to seek the assistance of the judicial enforcer (sudebnyi ispolnitel'). The petitioner ask for the assistance of the sudebnyi ispolnitel' in writing and must provide him/her with the ispolnitel'nyi list and the certification from the bank that there is no money in the defendant's account. At this point, the sudebnyi ispolnitel' is obliged to find the defendant and to locate assets equal to the amount of the judgment. The regulations provide that this

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2On gosarbitrazh, see Pomorski (1977).
3In the past, this document was known as an order (prikaz). (Art. 148, 1992 APK)
is to be accomplished within 20 days from the time the petitioner makes the appeal but, according to the sudebnye ispolniteli with whom I spoke in Saratov, that this requirement is “totally unrealistic” is well understood. How the sudebnyi ispolnitel’ goes about his/her job depends on the circumstances. Sometimes the defendants cannot even be located. Assuming the defendant can be located, the sudebnyi ispolnitel’ then has the task of identifying marketable assets and finding buyers. Only then does the “victorious” petitioner receive the damages.

Why is the implementation of arbitrazh court decisions so difficult? The causes are both institutional and operational: (1) the petitioner must take the initiative to get the decision implemented; (2) the arbitrazh courts have no in-house enforcement capacity; (3) legal limits on the ability to reach hidden assets of defendants; and (4) the illiquidity of many Russian enterprises.

**A. Heavy Burden on Petitioner**

The burden of ensuring that the decision is enforced rests entirely on the petitioner. The court does not require the defendant to report back after payment has been made. If the defendant does not pay on its own, then the petitioner will never recover the damages unless it takes further action. This is not unique to Russia. As a general matter, courts have limited internal enforcement power. It is assumed that the litigants will comply voluntarily with court decisions. This willingness to comply stems from their consent to the jurisdiction of the court, from their fear of being exposed as having evaded a court decision and, more generally, from the legitimacy of the court as an institution. (Shapiro, 1981) Legitimacy is built up gradually. The arbitrazh court is a relatively new institution and so has had little time to amass political capital (or legitimacy). Its efforts to build credibility are hampered by the negative legacy of its predecessor, gosarbitrazh. Moreover, non-compliance with arbitrazh court decisions has no adverse reputational effect. It has become so commonplace that few pay any heed. Whether the arbitrazh court will evolve into a meaningful element in the Russian legal system remains to be seen.

**B. Absence of Enforcement Division Within Arbitrazh Court Structure**

The sudebnye ispolniteli are not part of the hierarchical structure of the arbitrazh courts, but are part of the courts of general jurisdiction. Most of their time is spent enforcing judgments for

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4This has been a particular problem with the bank loans made during 1992 and 1993 that are now coming due. The documentation of the identity of the debtors was slipshod, and money was sometimes loaned to fictive legal entities, or to legal entities located at nonexistent addresses.

5When preparing the new Russian company law, efforts were made to limit the need to interact with arbitrazh courts. Their stated goal was to make the law self-enforcing. The impetus for doing so was the drafters’ lack of confidence in arbitrazh courts. See Black and Kraakman, 1996. More generally on path dependence, see Stark (1992).
these other courts. As a result, their primary loyalty is not to the arbitrazh courts. The process of enforcing judgments for the two court systems is different. Arbitrazh decisions often involve huge sums of money which can only be recovered through auctioning off the defendant’s assets. The sudebnyi ispolnitel’ has to be financially savvy enough to recognize which assets are marketable, and to obtain the fair market value. This is a far cry from garnishing wages to pay child support, which is the sort of activity the sudebnyi ispolnitel’ typically undertakes for the courts of general jurisdiction.

Given that everyone from the officials of the Higher Arbitrazh Court down to trial court judges and sudebnye ispolniteli agrees that the lack of an enforcement capacity is problematic, why has such a capacity not been created? The initial answers to this question always focused on money. One close associate of Yakovlev claimed that he had raised the issue with Chernomyrdin, but that the Prime Minister could not grasp the urgency. I find the budgetary argument unconvincing. To be sure, the funds of the Russian government are severely constrained, but other law-related administrative agencies have been created when a need is perceived. More convincing is an explanation that takes account of the power of the advocate for the new agency and the priority placed on having effective arbitrazh courts. When I got to know trial court judges better and reintroduced this question, they often acknowledged their skepticism of the facile explanation of no money. Of course, Yakovlev has had many issues to press, including the passage of the new APK and funding for the increased number of judges. Despite paying lip service to the problems of enforcement (Vasil’eva, 1996), it may have a lower place on Yakovlev’s agenda than other issues. Equally important is the marginal nature of arbitrazh courts within the Russian political landscape. My guess is that many Russians are unaware of their existence, and that what news they hear is less than flattering. The low status of sudebnye ispolniteli also plays a role. Upon reflection, the circularity and interrelated nature of the problems of creating the political will to make the arbitrazh courts more effective in the short run and of building legitimacy for the institution over the long run become apparent.

C. Convoluted Enforcement Procedure. Those involved in the process openly concede that if the defendant does not have the money in the bank to cover the damages, then the chances for recovery are slim. For example, in July 1996 a sudebnyi ispolnitel’ told me that, of the 25 enforcement actions then pending, only five stood some reasonable chance of collection.

The entire process is fraught with problems. As I already noted, some defendants are never located. Once located, the sudebnyi ispolnitel’ negotiates with the defendant with the goal of gaining

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6In Saratov, the sudebnye ispolniteli annually handle approximately 1200 enforcement claims for the courts of general jurisdiction, and less than 100 arbitrazh court cases.

7Recent examples include the anti-monopoly committees, the bankruptcy commissions, and the special tax commissions.
voluntary compliance. To this end, he/she issues a written proposal (predlozhenie) as to how the judgment could be satisfied containing a deadline for payment. If the defendant does not meet the deadline, then the sudebnyi ispolnitel' has no choice but to seize assets. He/she prepares an “act of inventory and seizure” (akt opisi i aresta). The critical part of this “act” is a list of property to be seized, along with a market value. The petitioner and the defendant have to agree on the values stated. If they cannot agree, then an expert is called in to make an assessment. In order to prevent the defendant from selling the assets and absconding with the money, the sudebnyi ispolnitel' either removes the assets or takes the title documents (pasport). Removing assets is complicated by the fact that sudebnye ispolniteli have access neither to cars or trucks for transporting the goods nor to warehouses in which the goods might be stored prior to auction. The window sills of the rooms in which these sudebnye ispolniteli work are piled high with various pieces of equipment waiting to be sold. The responsibility for selling the assets listed in the “act” rests with the sudebnyi ispolnitel'.

D. Inadequate Support of Sudebnye Ispolniteli. As the foregoing indicates, sudebnye ispolniteli are not adequately supported. This same complaint could be made by virtually any part of the Russian legal system, but the situation of the sudebnye ispolniteli is particularly troubling. Their work requires constant travel throughout the city, locating defendants, negotiating with them over their assets, and then seizing assets. Yet they are given no access to cars or trucks. They are left to

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8Sudebnye ispolniteli try to avoid using experts because the delays and expenses involved. Technically, the court should pay the cost of obtaining the expert. Recognizing that the budget is insufficient, the sudebnye ispolniteli tell the party disputing the price that it will have to find the expert and pay him/her. This provides a powerful incentive for the parties to compromise, thereby avoiding the need for experts.

9Transportation is not provided for any aspect of the work of sudebnyi ispolniteli. At every stage, they have to rely on public transportation, and they have to cover these costs (which have become significant in recent years) from their own pockets. Conversations with sudebnye ispolniteli uncovered incidents when they had to haul typewriters, adding machines, and larger pieces of machinery back to the office for safe keeping on public transportation.

10Each of these options poses difficulties for the sudebnyi ispolniteli. The budget does not provide funds to pay for advertisements or announcements of seized assets in the paper. Efforts are made, sometimes successfully, to convince the local papers to run the ads at no charge. Selling through stores that specialize in second-hand goods (kommissionnye magaziny) has become increasingly difficult. These stores recognize that the goods will be hard to sell, and often refuse to accept them. According to the law, auctions can be used to sell real property, but not moveable assets.

11I inquired as to whether petitioners seeking recovery ever threaten or take action to declare the defendant bankrupt. The sudebnye ispolniteli had not yet encountered such a case. They attributed the reticence on the part of petitioners to an inaccurate understanding of the law. Petitioners assume that, if the defendant becomes bankrupt, they will never recover. In reality, they would have a high priority among creditors to be repaid upon liquidation.
the vicissitudes of public transportation, and are expected to subsidize this transportation out of their salaries. In Saratov and Ekaterinburg, the majority of the sudebnye ispolniteli are women, and often they call on their husbands to help them haul heavy machinery. It struck me that the fact that most sudebnye ispolniteli are women and that they have low status is probably related.

E. Finding Hidden Assets

Trying to avoid paying judgments through claims of poverty is not unique to Russian defendants. It is an understandable (though not legal) reaction familiar the world over. What is somewhat unusual about Russia are the limits placed on petitioners and sudebnye ispolniteli, when acting as their agents, in seeking to recover judgments. One common response on the part of a losing defendant is to transfer assets to family members or other trusted colleagues. In the context of arbitrazh court decisions, the defendant is always a legal entity (not a physical person), so the defendant may disperse company assets to key managers and even to their family members. Such actions are illegal, but can be difficult to detect and unravel after the fact.

In other countries, procedures have been developed for finding diverted assets. In the United States, for example, it is possible to go after the assets of company officials if it is found that these officials have used the shield of limited liability to enrich themselves. This so-called "piercing of the corporate veil" is not commonplace, but it is possible. In Russia, it is not. Court officials are limited to seizing assets that are owned by the defendant, i.e., listed on its balans. Judges and sudebnye ispolniteli agreed that going after the personal assets of an enterprise director, even assuming it could be definitively proven that the assets had been diverted from the enterprise, would be impossible. Once the assets pass through the enterprise management to their family or others, the task becomes even more futile. A Saratov sudebnyi ispolnitel' recounted her unsuccessful efforts to help the victims of stock pyramid schemes over the past few years. At one point in 1995, as many as twenty victims would come to her every day with court judgments. According to their bank statements and other records, the defendants had no money. Yet to this sudebnyi ispolnitel', it was absolutely clear that the bank funds had been dispersed in illegal ways, such as overpaying for worthless assets. She is sure that she could have unravelled these illegal transactions if she had the time, authority, and resources.

One method of dealing with this problem is for the court to freeze enough of the defendant's assets (arestovat' imushchestvo) to cover the potential judgment. This is akin to putting the assets in

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12It goes without saying that sudebnye ispolniteli are underpaid, but this hardly makes them unique in Russia. In Saratov in July 1996, the monthly salary for a sudebnyi ispolnitel' with nine years experience was 200,000 rubles. At this time, judges earned, on average, one million rubles per month.

13Since the petitioners were all physical (not legal) persons, these were decisions from the courts of general jurisdiction. The underlying point, however, is the same.
escrow, i.e., they cannot be sold or otherwise encumbered until the case is resolved. (Fal’kovich, 1996) It can be done anytime after the case is filed. Implicit in such action is a distrust of the defendant. Indeed, freezing the defendant’s assets preemptively is open to question. The APK lists freezing assets as one of five permitted methods of ensuring that the case proceed.14 (art. 76-1, APK) Any petition for freezing assets must be ruled upon within one day of submission.15 The impetus may come from the court or from a petition filed by a participant in the case.16 The statutory language establishing the standard for granting such a petition is quite general. It states that the order may be granted whenever the circumstances of the case suggest that implementing the decision of the court will be “difficult or impossible.” (art. 133, GPK) When deciding on such a petition, the commentary advises the judge to consider the potential detrimental impact on the defendant. (Treushnikov, 1996, p. 200) My conversations with trial court judges indicate that they are well aware of the need to proceed with caution. As one Ekaterinburg judge put it, she cannot base the decision on a “feeling” of the plaintiff. She needs more. Typically, she places great weight on the behavior of the defendant.17 She also looks at prior behavior by the defendant. Interestingly, the likelihood of the petitioner prevailing on the merits is not considered. In theory, the court can punish non-compliance by the defendant with fines of up to fifty percent of the value of the case. As I noted earlier, arbitrazh judges do not routinely impose fines; I encountered no cases in which fines were assessed.

Although the petitioner has the right to request that the defendant’s assets be frozen, the request is not made in most cases. This seems illogical given that inability to enforce judgments is such a widespread problem. When I asked judges why more petitioners failed to take these steps, some placed the blame on poor knowledge of the law. They contended that petitioners were unaware of their rights and of the potential consequences of not acting preemptively. Other judges thought the reason might be a perception that it is difficult to get such an order. To some extent, this is accurate. Judges do not issue orders to freeze assets lightly. But it is possible and, depending on the circumstances, may be the only hope for recovery. The judges seemed to see the need for increased

14Article 92 of the 1992 APK also contemplated freezing assets. Most of the detail about how to seize assets comes in the rules for collecting on judgments (art. 156, 1992 APK), suggesting that freezing assets at the beginning of a case was not the norm.

15Art. 136, GPK. Note that the specifics regarding how to handle these petitions comes from the GPK, not the APK.

16I have observed only one instance where the court initiated the freezing of assets. In a 1994 Ekaterinburg case, the judges perceived the defendant to be unscrupulous and the petitioner to be hopelessly naive. Once the judgment was rendered, the presiding judge was immediately on the phone trying to get whatever was left in the defendant’s bank account frozen. She worried out loud that if she gave them enough time to get to the bank, then the account would be emptied.

17In one example where the request to freeze assets came after the case had been decided, the judge denied the request because she believed the fact that the defendant had paid the basic debt and part of the fine showed that it was trying to live up to the obligation.
use of this mechanism, but to date most petitioners do not. It is worth noting if such orders become routine, it may create new problems since defendants may be unable to pursue normal business activities if a significant portion of their assets are frozen. This problem has already arisen with respect to banks, and most judges said they would not freeze correspondent accounts. The goal, of course, is to increase the awareness of these orders so that they may be used when warranted.

F. Illiquidity of Enterprises

The problem with implementing arbitrazh decision goes far deeper than flaws in legal procedures or inadequate funding. It can be traced back to the lack of liquidity of Russian enterprises. As has been well-documented, many enterprises are unable to cover normal business expenses, such as wages and taxes. Debts owed to utilities have lead to highly publicized service shut-offs. The non-payment crisis has had a domino effect throughout the Russian economy. Not surprisingly, enterprises are also deeply in debt to their suppliers. Efforts have been made to remedy the crisis by requiring partial or even full pre-payment before goods will be shipped. But the problems persist. Some portion of these non-payment cases ultimately end up in arbitrazh court. For the most part, they are open-and-shut cases. But the judgment only puts the debt on the public record; the defendant still has no money.

III. Conclusion

The question this analysis raises is why anyone bothers to go to arbitrazh court. I put this question to judges and sudebnye ispolniteli. The most common answer was that the petitioner needed to show that it had taken all steps possible to recover on the debt before writing it off. Whether this was a legally-imposed requirement was unclear. For banks, I was told that the Central Bank had issued a regulation requiring a court judgment before a bad debt could be taken off the books. The sudebnye ispolniteli believe that petitioners bring cases knowing full well that recovery would never be had. Some judges were slightly less cynical, and argued that petitioners were trying to preserve their place in line by getting a court judgment. A few petitioners confirmed that this was their motivation.
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