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## RESOLUTION OF COMMERCIAL DISPUTES IN RUSSIA AND UKRAINE: IS MEDIATION A VIABLE OPTION?

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### **I. INTRODUCTION**

When preparing contracts for their clients engaged in business in Russia and Ukraine, lawyers usually devote considerable thought to the provisions on dispute resolution. Typically, a lawyer's analysis focuses on whether it is advisable to provide for international arbitration of disputes, as opposed to their resolution by the local commercial courts. The dispute resolution provisions of many contracts between western companies (or their wholly-owned subsidiaries) and their local joint venture partners, customers, suppliers, licensees or franchisees, typically read:

"The Parties shall attempt to resolve all disputes arising out of this Agreement by amicable negotiations. In the event that the Parties fail to resolve a dispute, they shall submit the matter to [\_\_\_\_\_]<sup>1</sup> for resolution in accordance with the rules thereof."

If the value of the contract is not great, the lawyer may advise to provide that the local commercial court have jurisdiction over a dispute (since the cost of arbitration under the auspices of an international arbitral body is likely to be high). In light of the difficulty in certain instances of enforcing foreign arbitral awards in Russia, some lawyers are recommending the use of the local commercial courts irrespective of the value of the contract.

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<sup>1</sup> For example, the International Court of Arbitration of the International Chamber of Commerce in Paris, the London Court of International Arbitration, the Arbitration Institute of the Stockholm Chamber of Commerce, or the International Arbitration Court of the Russian Chamber of Commerce and Industry.

Most attorneys do not give much thought to the first sentence of the above-provided dispute resolution clause as it is viewed simply as “boilerplate” that states the obvious: parties to a contract are unlikely to initiate an arbitration or file a claim in a court against a business partner until after seeking to resolve the dispute by negotiation. Unfortunately, this is not always the case.

In fact, many disputes before arbitrators and judges could have been resolved by the parties themselves had they engaged in a formal process aimed at reaching a mutually satisfactory settlement . There are many reasons why unstructured negotiations fail to resolve business disputes, even where both sides (at least initially) in good faith want to resolve a dispute. Among the most common reasons for the failure of negotiations are that the individuals involved in the negotiation may: (i) lack the authority to resolve the dispute, (ii) rely on incomplete or inaccurate information provided by subordinates, or (iii) have made unrealistic assessments of the merits of their case and the likelihood of achieving a favorable outcome if arbitration or litigation is pursued.

Direct negotiations are most likely to succeed where the parties are represented by individuals with a thorough understanding of the relevant issues, are committed to the continuation of a productive on-going relationship between the sides, and possess appropriate skills and demeanors for the conduct of negotiations. Unfortunately, this does not always exist. Consequently, it may be advisable to provide in contracts relevant dispute resolution procedures aimed at resolving disputes without the need for costly and uncertain arbitration or litigation, before such disputes in fact arise. While such processes could take a variety of forms used by U.S. businesses<sup>2</sup>, we believe that mediation may offer the most promising means of alternative dispute resolution<sup>3</sup> in Russia and Ukraine for certain types of disputes such as construction, franchise/concession

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<sup>2</sup> For example, neutral evaluations, fact-findings, mini-trials, summary jury trials, non-binding arbitration, med -arb (see Linda R. Singer, *Settling Disputes: Conflict Resolution in Business, Families and the Legal System* (Boulder: Westview 1994 (Second Edition) pp. 15-29).

<sup>3</sup> Usually, arbitration is classified as a form of “alternative dispute resolution” – that is, it is an alternative to litigation. With the increasing “litigization” of international commercial arbitration performed under the auspices of recognized international arbitral bodies, the advantages usually attributed to arbitration with respect to litigation have become less clear-cut. While parties to a contract may opt for a more streamlined process by independently organizing their own arbitration pursuant to UNCITRAL (or by agreeing to modify in advance other established arbitral rules), the outcome in each case is the same - a determination by a third party concerning a dispute, not one reached by the parties themselves. In contrast, mediation aims at the settlement of a dispute by the parties themselves with the assistance of one or more mediators.

agreements<sup>4</sup> or other arrangements where there is a possibility that the parties may be interested in resuming business-like relations.<sup>5</sup> In addition, mediation may be appropriate where both parties to a dispute are concerned about their reputation within a particular industry.

Mediation is a process in which a neutral third party (the mediator) seeks to assist two or more parties involved in a dispute to reach a voluntary, negotiated resolution of their differences. Ideally, the mediator is an individual (or team of individuals) who by virtue of special training, skills, and demeanor can help the parties to reach a workable settlement of some (preferably all) outstanding issues between them.<sup>6</sup> The mediator, however, has no authority to impose a solution on the parties. This is the crucial difference between mediation, on the one hand, and adjudication and arbitration on the other. Adjudication and arbitration are adversarial processes in which each of the parties seek to obtain a favorable decision from a decision-maker (e.g. a judge or arbitrator(s)), In contrast, a mediator is an organizer and facilitator of structured communications that provide the parties an opportunity to:

- (i) vent and diffuse feelings;
- (ii) clear up misunderstandings;
- (iii) determine underlying interests or concerns;
- (iv) find areas of agreement, and ultimately:
- (v) incorporate these areas into solutions devised by the parties themselves.<sup>7</sup>

Advocates of mediation believe that settlements created by the parties themselves are often superior to outcomes created by third-party decision-

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<sup>4</sup> See the Web Site of the Center for Public Resource, Inc. (CPR) Institute for Dispute Resolution at [www.cpradr.org/fran\\_397.html](http://www.cpradr.org/fran_397.html) identifying fifty franchise companies participating in the National Franchise Mediation Program.

<sup>5</sup> According to CPR's Model ADR Procedures: Mediation of Business Disputes (1991), mediation has been successful in resolving domestic and transnational business disputes relating to commercial, financial and real estate transactions, construction, technology, product liability, trademark and unfair competition, dealerships or franchises, private anti-trust, insurance coverage, partnerships or joint ventures, mineral extraction, employee discrimination, and defamation (p. 9).

<sup>6</sup> Although mediators may be attorneys by profession, they need not be. In fact, most mediators are not.

<sup>7</sup> Mediation for the Professional, Center for Dispute Settlement, Washington, D.C., 1997, p. 1 (unpublished).

makers primarily because such settlements can be better tailored to the particular circumstances of the parties than will an outcome dictated by a third party. In a wide variety of settings, available research indicates that mediation has had a success rate of 75-85%.<sup>8</sup> Other advantages mediation has over litigation (and arbitration if the arbitral award needs to be enforced) are privacy, speed, and cost.<sup>9</sup>

While one must avoid being unrealistically optimistic about the potential for mediation of disputes, given the scope of the problems businessmen have been experiencing in Russia and Ukraine with both adjudication and arbitration, the potential of mediation as an alternative should at least be considered.

In the following sections, we will briefly discuss (i) characteristics of business disputes in Russia and Ukraine, (ii) the mediation process, and (iii) mediation practices in Russia and Ukraine.

## **II. Characteristics of Business Disputes in Russia and Ukraine**

Western investors in Russia and Ukraine are increasingly finding themselves in commercial disputes with their joint venture partners, suppliers and customers. In the typical situation, the western party at the outset of a business relationship brings much needed capital and business know-how to a proposed project, introduces a new product in an untapped market or offers a service previously unavailable or only available at unacceptable standards. The Russian or Ukrainian party offers its local contacts, real property, personnel and savvy that makes it attractive as a business partner. Frequently, these business relations do not turn out as well as hoped. While in many cases this situation is the result of bad faith on the part of one or both parties, it is often the result of numerous other factors such as:

- ◆ a rapidly evolving legal, tax and business environment. Changes occurring in the market and changes in laws will have a disparate and often unanticipated impact on the parties to a contract. The continuation of existing business arrangements, often become less attractive than other opportunities. This happens most frequently where a party originally made an inaccurate assessment of the other

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<sup>8</sup> Cited in J. Michael Keating, Jr., "In Getting Reluctant Parties to Mediate: A Guide for Advocates", in CPR Institute for Dispute Resolution's *Alternatives*, Vol, 13, No. 1, January 1995, p 10. The American Arbitration Association reports that approximately 85% of its mediations settle (cited in Michael F. Hoellering, "Mediation and Arbitration: A Growing Interaction" in *Dispute Resolution Journal*, Spring, p. 24).

<sup>9</sup> See J. Michael Keating, Jr. *supra.*, p. 10.

party's commitment to the relationship or had unrealistically high expectations of what the other party could accomplish.

- ◆ significant turnover in key personnel.<sup>10</sup> Such personnel turnover can have far-reaching and harmful consequences for relatively new enterprises and business relationships where written contracts and formal procedures do not reflect the actual management arrangements followed on the ground. The role that staffing issues play in giving rise to business disputes in Russia and Ukraine is frequently underestimated due to a failure to appreciate the difficulty in finding skilled, motivated and loyal personnel, especially since supervisors in the home offices assigned to oversee their company's operations in Russia and Ukraine (or those of their subsidiaries) often lack relevant experience in these countries.

Not only are western businesses encountering the problem of an increasing number of business disputes (which even if positively resolved can be highly disruptive to successful commercial operations), there is the additional problem of achieving a favorable resolution to such disputes. Both Russia's and Ukraine's court systems can be tactfully described as being in the midst of an evolution. While significant progress has been made in recent years, both countries' judicial systems continue to be plagued by a shortage of experienced and motivated judges. Furthermore, Russian and Ukrainian judges are famous for their sometimes mechanical approaches to business disputes – making rulings based on arcane (for western businessmen) principles of civil law rather than the merits. International commercial arbitration may not be a reliable alternative to litigation as not only may the cost of such arbitration be prohibitive, but some western parties have found themselves unable to enforce favorable arbitration rulings despite the existence of the 1958 New York Convention.<sup>11</sup>

To further complicate matters, successful plaintiffs in Russia and Ukraine have frequently encountered difficulty in enforcing favorable court rulings. This

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<sup>10</sup> Most western multinational corporations placing expatriate personnel in management positions in their local subsidiaries hope that such individuals will remain in their positions for at least three years. Given the hardship involved in living in Russia and Ukraine, the average tenure of expatriate personnel is often shorter than that anticipated. Similarly, such companies have also experienced high turnover in their local middle and high level executives who having received western training leave to join "Russian firms because they often have a greater opportunity there to demonstrate their new-found knowledge and initiative and because in many cases the compensation offered is higher than that available at foreign companies." Segei I. Verobiev, Partner and Senior Consultant, Ward Howell International Moscow, "The Market for Top Executives in Russia: Rapid Growth and Limited Supply", *Expert*, April 1, 1996.

<sup>11</sup> The two most notable examples with respect to Russia are the "Subway Restaurant" case in St. Petersburg and the Aerostar Hotel dispute in Moscow.

situation is a result of a myriad of factors including problems in locating assets of defendants, as well as deficiencies in applicable legislation and a shortage of skilled and motivated court personnel.<sup>12</sup> Given that “traditional” forms of dispute resolution may not always be appropriate or effective, it may be appropriate for businesses to explore available alternatives.

### **III. The Mediation Process**

As noted above, mediation is a form of directed negotiation. The form the mediation will take is within the control of the parties.<sup>13</sup> For example, the parties may develop their own procedures for the mediation, perhaps based on the Commercial Mediation Rules of the American Arbitration Association<sup>14</sup>, those of the CPR Institute for Dispute Resolution<sup>15</sup>, or another private specialized mediation organization. Alternatively, the parties may agree to engage in “conciliation”<sup>16</sup> using the Conciliation Rules of the United Nations Commission of International Law (UNCITRAL)<sup>17</sup> or under the auspices and according to the rules of a recognized body such as the International Chamber of Commerce (“ICC”)<sup>18</sup>, the Stockholm Chamber of Commerce (“SCC”)<sup>19</sup> or the International

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<sup>12</sup> This situation with respect to Russia may improve with the adoption of new Laws “On Judicial Marshals” and “Executory Enforcement”, see Ethan S. Burger, “New Legislation on Enforcement of Judicial and Arbitral Decisions”, *Russia Business Watch*, Volume 5, No. 3, Summer/Fall 1997.

<sup>13</sup> The mediation literature distinguishes between two different “pure” approaches to mediation (actual mediations in fact may combine both). These approaches have been labeled “facilitative mediation” and “evaluative mediation”. In the first approach, the mediator explores the parties’ interests and then seeks to help them craft creative solutions that envision an on-going relationship of the parties. The second approach “focuses more on the respective parties’ legal rights and obligations, the strengths and weaknesses of their legal positions, the likely outcome if the case were tried in court, and what represents a fair settlement.” CPR Model Mediation Procedure Commentary, “The Mediation Process” at [www.cpradr.org/medcomme.htm](http://www.cpradr.org/medcomme.htm). See also Leonard L. Riskin, “Mediator Orientations, Strategies and Techniques”, *Alternatives*, Vol. 12, No. 9, p. 111.

<sup>14</sup> AAA, Commercial Mediation Rules, (as Amended and Effective on January 1, 1992).

<sup>15</sup> CPR Model Mediation Procedure for Business Disputes (Revised 1994).

<sup>16</sup> While the term “conciliation” is often used as a synonym for mediation, it sometimes is used to describe a similar, though distinct, process. Generally, conciliation may differ from mediation because conciliators may be authorized by the relevant rules to offer their own proposed settlements to the parties, rather than helping the parties to develop their own.

<sup>17</sup> UNCITRAL Conciliation Rules (1980). The UNCITRAL Rules are very flexible in that they grant the parties the right to exclude or vary the application of any provision to a particular conciliation case (Article 1, Point 2). Cases conducted under the UNCITRAL Rules may or may not be organized by a particular institution as the parties decide (Article 4).

<sup>18</sup> ICC Rules of Optional Conciliation (January 1, 1988). The ICC Rules provide for a single conciliator who is authorized “to conduct the conciliation process as he thinks fit, guided by

Centre for the Settlement of Investment Disputes (“ICSID”)<sup>20</sup>. Unfortunately, at the present time, these organizations have little if any experience in mediation of commercial disputes in Russia or Ukraine.

Irrespective of the rules selected for a mediation, the process can be generally understood as consisting of five inter-related stages:

1. The signing by the parties of an agreement to mediate (this may occur before or after the actual selection of the mediators). Although the contract governing business relations between the parties may have provided for mediation of disputes, such parties seldom sign a separate mediation agreement in advance. If the parties had not agreed to mediate previously, such a mediation agreement may be signed at any time after a dispute arises. In fact, it is not uncommon that mediation is pursued after an arbitration or adjudication has already begun.<sup>21</sup> The mediation agreement usually provides that (i) the mediation is voluntary and can be terminated by the parties at any time, (ii) mediation sessions and all materials prepared for the mediators are confidential, (iii) the parties do not have the right to subpoena any mediator or documents submitted to the mediators, (iv) a mediator will not disclose confidential information provided during the course of mediation, testify voluntarily on behalf of a party, or submit any type of report to any court or arbitral body in connection with the

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the principles of impartiality, equity and justice” (Article 4). As such, a “mediation” could be undertaken under the ICC Rules, though they envision that a conciliator may put forth his own settlement proposals (Article 11).

<sup>19</sup> SCC Arbitration Institute’s Conciliation Rules (1988). The SCC Rules are vague and therefore flexible. They grant the conciliator, as “guided by the wishes of the parties”, the right to “determine the manner in which the proceedings will be conducted and otherwise deal with the matter in an impartial, practical and speedy manner.” (Article 7).

<sup>20</sup> ICSID has two sets of conciliation rules. The first concerns disputes between an ICSID member-state and a national of another state (ICSID Rules of Procedure for Conciliation Proceedings printed in ICSID Basic Documents (January 1985)). Neither Russia nor Ukraine have ratified the ICSID Convention (although Russia has signed it). The other concerns disputes between other types of parties (ICSID Conciliation (Additional Facility) Rules, printed in ICSID Additional Facility for the Administration of Conciliation, Arbitration and Fact Finding Proceedings, Document ICSID/11, (Washington, D.C. June 1979). Generally, both sets of ICSID conciliation rules provide for more structured proceedings than those of other conciliation bodies. In many respects, ICSID conciliation rules resemble non-binding arbitration. Not surprisingly, ICSID has not sponsored many conciliations over the years.

<sup>21</sup> See e.g. Victoria A. Black and Butler J. Rondeno, Jr., “Converting Arbitration to Mediation”, *Dispute Resolution Times*, Fall 1997, at. 14.

case, (v) the relevant rules governing the mediation, if any, and (vi) perhaps the fees involved.<sup>22</sup>

2. Prior to holding the first mediation session, the mediator(s) may invite the parties to submit a written summary outlining the nature of the dispute. The mediator(s) will also discuss questions of a procedural nature with the parties and/or their counsel.
3. Initial meeting(s), most often joint with the parties, provide an opportunity for the mediator(s) to explain the process and to begin hearing from counsel and clients regarding the issues in dispute.
4. The initial meetings generally are followed by a series of meetings, both separate and joint, during which the mediator(s) explore the parties' respective interests in resolving the dispute, any significant barriers facing any of the parties and any options for settlement evident to them. It generally is in private meetings with the mediator(s) that parties feel free to be open regarding their settlement aspirations and potential settlement options. As the mediator(s) move from private meeting to private meeting they must take care to determine precisely which information learned from one party can be shared with another.
5. Through this series of meetings, the mediator(s) will help the parties to identify those areas in which they are in agreement and those areas in which they are not. Ideally, the mediator(s) will be able to assist the parties in increasing the areas of agreement and, correspondingly, reduce the areas of disagreement. The ultimate goal of the mediator(s) is to aid the parties in reaching a final and binding resolution of their dispute enforceable by the local courts as a contract.

The mediation process outlined above can be refined according to the needs of the parties. For example, it may be necessary to use the services of independent experts who can suggest compromise solutions or provide standards to allow the parties to evaluate their respective positions.

#### **IV. Mediation in Russia and Ukraine**

While the appearance of mediation as a formal process of dispute resolution is a relatively recent development, the mediation of business disputes

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<sup>22</sup> If a particular party is not very familiar with mediation, it is advisable that a mediation "handbook" providing an overview of the goals and process of mediation be provided in such party's native language.

by (not entirely) neutral third parties is not. During the Soviet era, western scholars noted that the local communist party secretary often found himself having to mediate disputes between enterprises and other entities located bureaucratically under the jurisdiction of different ministries and state committees.<sup>23</sup> These communist party officials found themselves in situations where they were capable of brokering settlements (though this often occurred only after promising benefits or threatening consequences if the parties did not resolve the dispute themselves, before being heard by state arbitration bodies.<sup>24</sup>

Recently, Russia has begun to use conciliatory commissions (at which labor and management are equally represented) and professional mediators to resolve employment and other labor disputes.<sup>25</sup> In addition, last year Ukrainian President Leonid Kuchma by presidential edict created the "Chamber of Independent Experts on Issues of Foreign Investment."<sup>26</sup> Such experts will compose three member panels that will examine disputes between foreign investors and Ukrainian state bodies, and issue recommendations on how to resolve them. It is hoped that such recommendations may serve as a basis for a quick and inexpensive resolution of the disputes without the need to resort to adjudication or arbitration. It is not clear from the Chamber's regulations whether such recommendations are binding. The Chamber's panels have the authority to send their "decision" to the Ukrainian President and other state bodies with a recommendation that such decision be implemented, and President Kuchma has indicated informally that he regards such recommendations binding on the parties to the dispute.

The use of formal mediation as a tool for dispute resolutions seems to be slowly taking hold at the grass roots level in both countries.<sup>27</sup> This is not

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<sup>23</sup> See e.g. Jerry F. Hough, *The Soviet Prefects: The Local Party Organs in Industrial Decision-Making*, Cambridge University Press, 1969.

<sup>24</sup> Maybe for this reason, China is estimated to have ten million mediators (see Lemoine D. Pierce, "Mediation Prospers in China", 49 *Dispute Resolution Journal* 19 (1994), p. 21.

<sup>25</sup> See Russian Law "On the Procedure for Resolving Collective Labor Disputes", dated November 23, 1996. Ukraine uses an alternative means of resolving certain labor disputes that is more formal than mediation and more closely approximates conciliation (see Ukrainian Labor Code, dated December 15, 1993, Chapter XV).

<sup>26</sup> See Ukrainian Presidential Edict No. 432/97, "On Issues of the Chamber of Independent Experts on Issues of Foreign Investment", dated May 14, 1997 (approving Regulations of the Chamber and relevant procedures).

<sup>27</sup> We use the word formal here since local businessmen will often rely on their *krysha* (the persons or organizations being paid to "protect" their businesses) to "informally" settle their disputes. In the case when both parties have their own paid protection organization or individuals, the latter have been known to hold so-called "criminal courts" that seek to resolve the

surprising given the relatively limited history of the private practice of law (other than in family law matters, non-commercial civil disputes and criminal defense work) and the general non-litigious nature (to date) of the population. Independent mediation centers (such as the Ukrainian Conflict Resolution Association, the Ukrainian Mediation Group, the Moscow Center on Conflict Resolution, Prevention and Research, and the St. Petersburg (Russia) Conflict Resolution Center), often supported by western non-governmental organizations such as the American Bar Association and the Search for Common Ground, are beginning to offer mediation services in the areas of family, employment, small claims and consumer disputes.

To our knowledge, formal mediation of commercial disputes between western and local parties has not been used widely in either Russia or Ukraine. Nevertheless, we believe that it holds promise for western businesses active in both countries. It has been our experience that Russian and Ukrainian business people, to a greater extent than their western counterparts, have a fairly significant need to “save face” in disputes. Perhaps this characteristic arises from a sense of feeling less sophisticated than their western counterparts. Maybe it is a product of being less familiar with international business practices. For whatever reason, the adversarial nature of either arbitration or adjudication can aggravate this characteristic that exacerbates an already tense situation.

While we believe that mediation could be successful in certain types of disputes between western and Russian or Ukrainian parties, we recognize that cross-cultural disputes can make international commercial mediation difficult. Mediation depends on successful communication. Differences in language, gestures and negotiating style are more acute in transnational mediations. To have the greatest likelihood of success, we would advise that a mediation team be used consisting of a mediator from the home country of each of the parties involved in the dispute.

Ideally each mediator should have undergone common training and have a proven ability to work together. Each mediator should have some experience dealing with persons of the same nationality as the parties to the dispute and have some facility in the languages of both parties to the dispute so as to be able to converse, at least minimally, with the parties in their native language.

Whether mediation develops as an accepted way to resolve commercial disputes in Russia and Ukraine, it is likely to be “demand”-driven in the coming years. If dissatisfaction with commercial courts and arbitration continues,

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dispute on the merits. See e.g. Yurii Feofanov, *Arbitration Court Facing Black Business*, *Izvestiia*, September 21, 1995, at 2, available in LEXIS World Library.

business persons will be eager to find alternative means to resolve their disputes. Both countries currently lack a supply of trained and knowledgeable mediators. But as in market economies, demand will no doubt give rise to a greater supply.

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