

## THE SCOPE OF THE ARBITRAL AWARD BINDING EFFECT (INTERESTS OF «THIRD PARTIES» IN INTERNATIONAL ARBITRATION)

NATALIYA BOCHAROVA,  
Lomonosov Moscow State University  
(Moscow, Russia)

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*Modern business international transactions are multiparty and complicated. Such contracts are usually composed of several contracts which can contain bilateral dispute resolution arrangements. According to the principle of parties autonomy dispute arising between two persons bound by an arbitration agreement in connection with a multiparty project will be resolved by arbitration exclusively between these two parties. Other parties cannot participate in the resolution of the dispute through arbitration, even if they have played an active role in the actual project. Notwithstanding any legitimate interest, they might have the outcome of the dispute; these parties will remain alien both to the arbitration proceedings and an arbitral award. Their interests are not taken into consideration and left unprotected. Arbitration proceedings, unlike litigation, usually do not bear any intervention or joinder of parties, which is explained by the contractual nature of arbitration.*

*Thus, the binding power of an arbitral award extends only over parties of an arbitration agreement. Meanwhile, an arbitral award can affect interests of third parties. How can these parties defend their interests in arbitration proceedings and during recognition and enforcement proceedings in national courts? There are two ways of resolving such problem in state court litigation. The first one is the compulsory participation of any third party with any legitimate interest in litigation through intervention, joinder of parties, and consolidation of cases. A court ex officio has to gather all parties that can have any legitimate interest in resolving the dispute. If judgment affects any interest of a party that was not involved in the proceedings judgment should be reversed in appellate court. The second way is also the solution against parallel proceedings. This way is to harmonize the outcome of parallel proceedings by the principle of lis pendens and res judicata.*

*The paper examines the binding and res judicata effects of the arbitral award towards third parties through the Russian and international experience of defending of interests of third parties in international arbitration and litigation.*

*Keywords: civil procedure; international commercial arbitration; intervention; arbitral awards; res judicata; third parties.*

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## Introduction

The problem of the participating of the third parties in arbitration is not new to the legal science.<sup>1</sup> It is obvious that as a general rule an arbitral award has binding effect only for the parties to the arbitral agreement. This rule originates from the main principle of arbitration – the principle of the party autonomy. But modern business transactions especially in an international context are extremely complicated and meant the participation of several parties. Also, the complicated structure of many multinational groups and companies requires several affiliates, subsidiary companies, directors or even stockholders of the same group to become actively involved in the execution of the contract.<sup>2</sup>

Usually, such multiparty projects are executed through several agreements some of which could have an arbitration clause. It leads to the situation where jurisdiction for the multiparty projects disputes is fragmented. Each dispute has its forum (state court or arbitration tribunal). In arbitration, notwithstanding any legitimate interest, a party that is not part of the arbitral agreement could not participate in the resolution of the

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<sup>1</sup> See Stavros Brekoulakis, *Third Parties in International Commercial Arbitration* (Oxford: Oxford University Press, 2011).

<sup>2</sup> *Id.* at 14.

dispute in arbitration proceedings. As an example, the following current case can be considered. Two contracts were concluded: the supply contract with the arbitration clause and the insurance contract with no jurisdictional clause. The insurance contract establishes that the insurance company has to pay insurance money for defective goods in case if the supplier would not pay the damages to the buyer. The buyer brings an action to arbitration tribunal against the supplier and loses his case. So the buyer gets the arbitral award that proves that the supplier has not paid the damages to the buyer. The buyer brings an action against the insurance company and request insurance money. The question is what effect this arbitral award has for the insurance company in subsequent adjudication in the state court. There is not only a question of the effect the arbitral award but also a wider question of the distinguishing of the question of law (so called legal qualification), question of issues (facts) and applying final awards and judicial decisions in the subsequent proceedings.

It is worth to begin with analyses of the legislation and case law concerning the litigation in the state courts. How to protect a third party from the binding effect of the judicial decision? There are only two ways. The first one is a compulsory participation of any third party with any legitimate interest in the litigation through intervention, joinder of the party, consolidation of cases. It is compulsory for the court which *ex officio* has to gather all parties that can have any legitimate interest in resolving a dispute. If a judgment affects any interest of a party that is not involved, this judgment is considered as unlawful and should be reversed. The second way is also the solution against parallel proceedings. This way is to harmonize the outcome of parallel proceedings. So here the principle of *lis pendens* and *res judicata* are working to prevent conflicting decisions.

The first way is preferable and national civil proceedings give precedence to it. First of all, because it more ensures rights of such nonparticipating third parties.

The question is can these methods be applied to arbitration. The first method does not work in arbitration. It is possible in some arbitration institution to bring to trial a third party, but national legislation limits this possibility. The consent of both parties, of one party and the third party, both parties and the third party are required. The general rule is that only the party of the agreement can be in arbitration. Exclusions from this rule are quite rare. The participation of a third party is not usual. An arbitration tribunal could not *ex officio* bring any party to the action. And it is proved to be effective. The third party can participate if it wants to defend his rights and suffer or enjoy the effect of the arbitral award.

The second way is to extend *res judicata* effect of the arbitral award to the third party. This, first of all, violates the fundamental right to be heard. Secondly, it does not resolve the problem because the understanding of the *res judicata* effect of an arbitral award is not clear even for the participated parties. *Res judicata* is not only about binding effect. It also prohibits reassertion; it has enforcement effect and evidentiary presumption effect. And it is not obvious that even after recognition of

the arbitral award it would have the same *res judicata* effect as a judicial decision for the interested parties and the state courts and arbitral forum.

In mentioned example can party of the agreement (the buyer) in the state court refer to arbitral award as it contains some collateral estoppel (“goods were defective”). From Russian practice, the answer is no. It works only for the facts set up by state courts. In Russian precedent law including the Constitutional Court of the Russian Federation practice, it is admitted the right of such third party with significant interest to ask a state court to annul or void an arbitral award. The reason is that his right to be heard and public policy were violated. The third party is meant to go to the court to ask to set the award aside. In some countries, state court applies *lis pendens* principle when two parties are in arbitration proceedings, and one party and the third party are in litigation in a state court. In this case, court suspends proceedings, but it happens quite rare.

One more solution is to admit that an arbitration tribunal has no competence or jurisdiction to resolve a dispute that affects the right of the third party. This idea can be found in the court practice of Latvia.

One more mechanism to protect rights of the third party is not to extend *res judicata* effect. So third party during adjudication in state court could challenge the rights, relation or facts stated by an arbitral award. Here no process of setting arbitral award aside is needed.

There is no unified decision now how to protect a third party interest in an arbitral award. The same can be said about the possibility of the third party to take advantages of the arbitral award that protects its right. But arbitration awards are worldwide recognized and enforced, so it is worth to have some unified way to resolve this problem.

We should find the balance between private and public nature of an arbitral award, provide party autonomy that limits the effect of arbitral award but at the same time we should give more credits to the arbitration and approximate it to the state adjudication.

## **1. *Res Judicata* and Legal Power of Judicial Decisions of State Courts: Brief Overview**

The doctrine of *res judicata* is well established in the common law jurisdictions of England, Ireland, Canada, India, Australia and New Zealand.<sup>3</sup> In civil law countries, we usually distinguish legal power (effect) of a final judicial decision (*force de chose jugée, materielle Rechtskraft*). Even superficial analysis of the *res judicata* and the legal effect doctrines shows that core of these theories is similar. But there are a lot of differences

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<sup>3</sup> Interim Report on *Res Judicata* and Arbitration, Berlin Conference (2004) (Mar. 3, 2017), available at [www.ila-hq.org](http://www.ila-hq.org).

and peculiarities which have been developed in these different jurisdictions what make it impossible to reach unified approach to the idea of legal effects of judicial decisions and arbitral awards. Such unified approach was unnecessary while these doctrines concern state court judgments. But when we try to use these concepts to the international arbitration awards all these diversities prevent us from the clear answer to the question what *res judicata* or other legal effect does arbitral awards have.

In this section the both doctrines will be briefly analyzed to make some grounds to consider *res judicata* or other legal effects of an arbitral award.

### **1.1. Res Judicata in Common Law Countries**

For a decision to qualify as a *res judicata*, it must be pronounced by a judicial tribunal of competent jurisdiction and must be final and conclusive and on the merits.<sup>4</sup> The effect of a *res judicata* decision is that it disposes finally and conclusively of the matters in controversy, such that – other than on appeal – that subject matter cannot be re-litigated between the same parties (or their privies).<sup>5</sup> The *res judicata* effect of an earlier decision is raised by a party in subsequent proceedings by pleading: the cause of action estoppel; or issue estoppel. If accepted, the plea will have the effect of precluding the other party from contradicting the earlier determination in the later proceedings. The rules of estoppel by *res judicata* are rules of evidence.<sup>6</sup>

*Res judicata* is a portmanteau term which is used to describe some different legal principles with different juridical origins. The first principle is that once a cause of action has been held to exist or not to exist, that outcome may not be challenged by either party in subsequent proceedings. This is “cause of action estoppel.” It is properly described as a form of estoppel precluding a party from challenging the same cause of action in subsequent proceedings. Secondly, there is the principle, which is not easily described as a species of estoppel, that where the claimant succeeded in the first action and does not challenge the outcome, he may not bring a second action on the same cause of action, for example, to recover further damages. Third, there is the doctrine of merger, which treats a cause of action as extinguished once judgment has been given upon it, and the claimant’s sole right as being a right upon the judgment. Although this produces the same effect as the second principle, it is, in reality, a substantive rule about the legal effect of judgment, which is regarded as “of a higher nature” and therefore as superseding the underlying cause of action.<sup>7</sup> A corresponding rule has applied in England by Civil Jurisdiction and Judgments Act 1982 to foreign judgments. Fourth, there is the principle that even where the

<sup>4</sup> Peter R. Barnett, *Res Judicata, Estoppel and Foreign Judgments* 11 (Oxford: Oxford University Press, 2001).

<sup>5</sup> *Id.* at 8.

<sup>6</sup> *Carl-Zeiss Stiftung v. Rayner & Keeler Ltd. (No. 2)* [1966] 2 All ER 536 at 564 (HL).

<sup>7</sup> *Virgin Atlantic Airways Ltd. v. Zodiac Seats UK Ltd.* [2013] UKSC 46 (July 3, 2013).

cause of action is not the same in the later action as it was in the earlier one, some issue which is necessarily common to both was decided on the earlier occasion and is binding on the parties. "Issue estoppel" was the expression devised to describe this principle. Fifth, there is the principle first formulated in *Henderson v. Henderson* (1843), which precludes a party from raising in subsequent proceedings matters which were not, but could and should have been raised in the earlier ones. Finally, there is the more general procedural rule against abusive proceedings, which may be regarded as the policy underlying all of the above principles with the possible exception of the doctrine of merger.

The cause of action estoppel arises where the cause of action in the later proceedings is identical to that in the earlier proceedings, the latter having been between the same parties or their privies and having involved the same subject matter. In such a case the bar is absolute in relation to all points decided unless fraud or collusion is alleged, such as to justify setting aside the earlier judgment. The discovery of new factual matter which could not have been found out by reasonable diligence for use in the earlier proceedings does not, according to the law of England, permit the latter to be re-opened. Issue estoppel may arise where a particular issue forming a necessary ingredient in a cause of action has been litigated and decided and in subsequent proceedings between the same parties involving a different cause of action to which the same issue is relevant one of the parties seeks to re-open that issue.<sup>8</sup>

So there are some difficulties concerning its application even to state court judgment. When *res judicata* is usually discussed the conclusive and preclusive effects are implied. The binding characteristic of a judicial decision is not part of this conception.

The key principles governing the doctrine of *res judicata* (both issue estoppel and cause of action estoppel) are 1) the decision of the first proceedings must be final; 2) *res judicata* applies to the same parties and their privies.

*Res judicata* effects of judgment are limited by the doctrines of privity and mutuality. According to the doctrine of privity only the parties or privies to the proceedings which gave rise to the *res judicata* can benefit or be bound by it in subsequent proceedings. The parties must be identical in all proceedings or privies to the parties in the first proceedings. No third person can rely on the effects of a *res judicata* or be bound by it.<sup>9</sup>

*Res judicata* in common law countries relies upon broad judicial discretion. In contrast to civil law countries where quite strict triple identity test (same claim, same grounds of claim, same parties) is applied, *res judicata* rules tolerate more flexible approach (the concept of privies of the parties, the idea of *Henderson v. Henderson* case, etc.).

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<sup>8</sup> *Arnold v. National Westminster Bank Plc.* [1991] 2 AC 93.

<sup>9</sup> Barnett 2001, at 96.

The main reason why *res judicata* has effect only when the same party test is passed is the recognized by all jurisdiction right to be heard. Any person whose rights and obligations are directly or indirectly are affected by the proceedings and adjudication should have right to participate in adversarial proceedings and set forth its side of the case.

But the same party test in the modern civil procedure is not strict enough to be considered as the literal identity of all participants of the proceedings with even the same procedural status. On the contrary both in common law and civil law the range of the “parties” who suffer or enjoy the effect of the judicial decision is wider than just participating parties.

In common law civil procedure the category of “privies” is used to identify all persons, who have community or privity of interest with the participating party. A privy is a person who has right to participate in the proceedings and who has some interest in its outcome. Usually, such persons should be noticed about proceedings. But their nonparticipation does not exclude the effects of *res judicata* towards them. The following persons can be considered as privies of the parties in the case law of common law countries:

- 1) a director of the company and company;
- 2) individuals who own or control the company and the company;
- 3) one company being alter ego of another company;
- 4) a bank solicitor and a bank;
- 5) an insured and the insurer;
- 6) a wife and a husband;
- 7) a stockbroker and a client etc.<sup>10</sup>

Also, the doctrine of judgment *in rem* should be mentioned. The doctrines of issue estoppel and cause of action relate to judgment *in personam* or *inter partes*, that is, they relate to judgment between parties. A judgment *in rem* results from an action *in rem*. An action *in rem* is proceedings to determine the status or condition of the rem itself. A judgment *in rem* is conclusive against all persons, not only against the parties to the proceeding. As an example of judgment *in rem* the following judicial decisions can be named: the ownership of land, a lawful non-conforming use of property; an abatement of rent order under rent control legislation; an adoption; the validity of treaty and others.<sup>11</sup>

### **1.2. Legal Effect of a Judicial Decision in Russia and Other Civil Law Countries**

The title of the article is “binding effect” of an arbitral award. Deliberately the words *res judicata* is avoided. *Res judicata* concept is not congruent in the different jurisdictions. There is one common *res judicata* rule which is the preclusive effect

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<sup>10</sup> Donald J. Lange, *The Doctrine of Res Judicata in Canada* 73 (4<sup>th</sup> ed., Toronto: LexisNexis, 2015).

<sup>11</sup> *Id.* at 375.

of any final judgments. Any decided case between the same parties could not be adjudicated again. Such interpretation is inherent in common law jurisdiction. There is a significant difference between understanding of the finality of a judgment in common law and civil law countries. In common law countries, the judgment is final when it rendered and resolved the dispute. In civil law countries, the judgment is not final before it comes into force.

The legal effect of a judgment in Russia means that a decision of a state court after the expiration of the term for appeal comes into force and has the following effects (consequences):

1. The preclusive effect which prohibits the plaintiff from re-litigation of the same claim, with same grounds against the same defendant.<sup>12</sup> In contrast to *res judicata* in common law countries, there are some possibilities to evade this rule by changing the remedy or the cause of action. The preclusive effect in Russia does not cover the claim that should have been raised but were not.

2. Conclusiveness of the judgment that comes into force means that the court that decides the case cannot change his decision (except the appeal, addition decision, and correction of clerical and arithmetical errors).

3. Collateral estoppel effect (or prejudicial effect) that means that once a court decides an issue of fact necessary to its judgment, that decision precludes re-litigation of the same issue on a different cause of action between the same parties. Art. 61 of the CivPC and Art. 69 of the ComPC state that issues established by a judicial act of the court that entered into legal force are not proved again when the commercial court considers another case in which the same persons participate. Issues established by a judicial decision that has entered into legal force are binding to the court. These issues could not be proven again and could not be challenged when considering another case in which the same persons participate. At the same time in the Decision of the Plenum of the Supreme Court of the Russian Federation of December 19, 2003 No. 23 "On the Judicial Decision"<sup>13</sup> the Court stated that persons who did not participate in the case have the right to challenge facts, established by the first judicial act. In such cases, the court adjudicates by a full study of all the evidence, introduced in the second trial.

4. Binding effect of the judgment which has both subjective and objective limits. Subjective limits narrow the power of the judicial decision to the participants of the resolved dispute (parties, third parties). Objective limits extend the effect of the judgment to the court, state bodies, legal entities, and all other persons.

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<sup>12</sup> Art. 150 of the Commercial Procedure Code of the Russian Federation (hereafter – ComPC); Art. 220 of the Civil Procedure Code of the Russian Federation (hereafter – CivPC).

<sup>13</sup> Постановление Пленума Верховного Суда РФ от 19 декабря 2003 г. № 23 "О судебном решении," Бюллетень Верховного Суда РФ, 2004, № 2 [Decision of the Plenum of the Supreme Court of the Russian Federation No. 23 of December 19, 2003. On the Judicial Decision, Bulletin of the Supreme Court of the Russian Federation, 2004, No. 2].

5. Enforcement effect means that a judgment will be enforceable both voluntary and coercive only after it comes into force.

As a general rule, the legal effect of a judgment extends only to the parties and their successors. All consequences of the legal effect of a judgment refer to the parties to the dispute (or even only plaintiff). And only one characteristic of the final judgment – binding effect – can be considered from the point of view of the party, who did not participate in the proceedings.

Art. 13 of the CivPC and Art. 16 of the ComPC state that the judicial acts of the court that have entered into legal force are mandatory for state authorities, local self-government bodies, other bodies, organizations, officials and citizens and are subject to execution throughout the territory of the Russian Federation.

The subjective limits of the judicial decision are a controversial topic in Russian legal science. The position towards subjective limits of the binding effect of a judgment depends on the theory of substantive or procedural nature of this decision itself. The procedural nature of the judgment means that through adjudication the court could achieve only procedural (formal) truth. The judicial decision (except for constitutive judgments that originate or terminate rights and obligation; *Gestaltungsurteile*) is only an act, that states that the plaintiff failed to prove his right or managed to do it in civil proceedings. From such procedure law point of view, a judicial decision can be applied only to the parties who participate in the proceedings. The judicial decision does not establish rights and therefore could not affect any rights, including the rights of the third persons. From this point, the judicial decision is only an instrument for coercive enforcement of the claim.

From the substantive theory of a decision, the binding effect of the judicial decision in the civil case is considered as all subjects on the territory of the Russian Federation are obliged to coordinate their behavior in according to the conclusion of the court concerning the legal relation stated by him.<sup>14</sup>

The external effect of the legal relation, and in particular the legal relation that has acquired legal certainty as a result of a judicial decision, may affect and, in practice, often affects rights and interests of the outsiders of the process, in particular:

1) the judicial recognition of the absolute rights (*rights in rem*) of one person (property rights, copyright) by the universality of the decision excludes the same right from any other person;

2) in the case of the origination of someone else's right from another (main) right, which is recognized or changed by the judgment, a change in the derivative right is caused.<sup>15</sup>

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<sup>14</sup> Комментарий к Гражданскому процессуальному кодексу Российской Федерации (постатейный) [Commentary to the Civil Procedure Code of the Russian Federation (Itemized)] 41–42 (G.A. Zhilin (ed.), Moscow: Prospect, 2003).

<sup>15</sup> Гурвич М.А. Избранные труды [Mark A. Gurvich, *Selected Works*] 618 (Krasnodar: Sovet. Kuban, 2006).

The decision of the court may affect the rights and obligations of third parties not only by the direct indication of such rights and obligations in a court decision but also indirectly, by determining the disputable legal relation on which a derivative legal relation with one of the parties is based. The decision of the court may become that legal fact by which the legal relation of the parties and the third party can arise, change or even terminate. In this case, as a general rule, the court decision should not directly determine such legal relation, since the court has to resolve the substantive dispute and determine only the legal relations that have arisen between the parties.

For example, in the event that a pledgee applies foreclosure of mortgaged property on the grounds provided for by law or by a mortgage agreement, all lease rights and other rights of use with respect to this property granted by the pledgor to third parties without the consent of the pledgee after the conclusion of the mortgage agreement are terminated. So when the court resolves the claim for foreclosure on pledged property, the rights of the tenants of mortgaged property and other persons are affected.

In the Decision of the Plenum of the Supreme Arbitration Court of the Russian Federation of July 12, 2012 No. 42 "On Certain Issues Related to Resolution of Disputes Related to Surety"<sup>16</sup> the Court indicated that when considering disputes between the creditor, the debtor and the guarantor who bear joint responsibility with the debtor, the courts should proceed from the fact that the creditor has the right to bring claims simultaneously to the debtor and the guarantor; only to the debtor or only to the guarantor. At the same time, the Court determined that the circumstances established in the dispute between the creditor and the guarantor, in which the debtor did not participate, are *taken into account* by the court when considering other disputes involving the guarantor and the debtor, for example, in the consideration of the recovery of the funds paid by the guarantor to the creditor. If in considering the dispute, the court will come to other conclusions than those contained in the judicial act in the case between the creditor and the guarantor, he must *indicate the relevant reasons*.

In theory, such idea is justified by the principle of "respect for the conclusions of the court contained in an earlier legally enforceable act."<sup>17</sup> Formally, such judicial decision would not have any prejudicial effect, as it fails the triple test (same parties).

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<sup>16</sup> Постановление Пленума Высшего Арбитражного Суда РФ от 12 июля 2012 г. № 42 "О некоторых вопросах разрешения споров, связанных с поручительством" [Decision of the Plenum of the Supreme Arbitration Court of the Russian Federation No. 42 of July 12, 2012. On Certain Issues Related to Resolution of Disputes Related to Surety] (Mar. 19, 2017), available at [http://www.arbitr.ru/as/pract/post\\_plenum/58414.html](http://www.arbitr.ru/as/pract/post_plenum/58414.html).

<sup>17</sup> Бевзенко Р.С. Комментарий к постановлению Пленума ВАС РФ от 12 июля 2012 г. № 42 "О некоторых вопросах разрешения споров, связанных с поручительством," 6 Вестник ВАС РФ 136 (2013) [Roman S. Bevzenko, *Commentary to the Decision of the Plenum of the Supreme Arbitration Court of the Russian Federation of July 12, 2012 No. 42 "On Certain Issues Related to Resolution of Disputes Related to Surety,"* 6 Bulletin of the Supreme Arbitration Court of the Russian Federation 136 (2013)].

However, the position expressed by the Court concerning “taking into account” the circumstances established in the dispute case in which the debtor did not participate demands special “credibility” for the court.<sup>18</sup>

The Russian case law has been developing in the way of admitting that it is possible that the judicial decision can affect the rights of the third party and gives such parties mechanisms to protect their rights, in case they consider that their rights were infringed by the judicial decision.

First of all, a judge *ex officio* has right to bring to trial any third party or in some cases co-defendant. Potential co-plaintiff and the third party with an independent claim should be noticed by the court about the current litigation, which gives such party the right to bring an action, which would be litigated in the same proceedings.

In case the decision affects the rights and obligations of the persons, which did not participate in the litigation, the judgment should be canceled by an appellate court. That will be so-called indisputable grounds to recall the judgment.

In some cases, the judge is bound by the law to bring such third party to the trial. For example, Art. 462 of the Civil Code of the Russian Federation establishes that if the third party brings a claim for the seizure of the goods on the basis that emerged prior to the performance of the sale contract, the buyer must bring the seller to the case, and the seller must enter into this case on the buyer’s side. The seller who does not participate in the case would have no right to prove the wrong conduct of the case by the buyer.

## 2. Legal Effect of Arbitral Awards

The subject of *res judicata* before international arbitral tribunals has been discussed recently in plenty of works.<sup>19</sup> The International Law Association (ILA) at the 72<sup>th</sup> Conference of the International Law Association held in Toronto, Canada, 2006 considered the Final Report on *Res Judicata* and Arbitration as well as the Report on *Lis Pendens* and Arbitration by the Committee on International Commercial Arbitration.<sup>20</sup>

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<sup>18</sup> Бочарова Н.С. Институты *interventio accessoria* и *quasi interventio* в современном процессуальном праве, 4 Вестник МГУ. Сер. 11. Право 54 (2013) [Nataliya S. Bocharova, *The Institutes of Interventio Accessoria and Quasi Interventio in Modern Civil Procedure*, 4 The Moscow University Herald. Series 11. Law 54 (2013)].

<sup>19</sup> Gary B. Born, *International Commercial Arbitration* (The Hague: Kluwer Law International, 2009); Stavros Brekoulakis, *The Effect of an Arbitral Award and Third Parties in International Arbitration: Res Judicata Revisited*, 16(1) *The American Review of International Arbitration* (2005); Norah Gallagher, *Parallel Proceedings, Res Judicata and Lis Pendens: Problems and Possible Solutions in Pervasive Problems in International Arbitration* (L.A. Mistelis, J.D.M. Lew (eds.), Alphen aan den Rijn: Kluwer Law International, 2006); Audley Sheppard, *The Scope and Res Judicata Effect of Arbitral Awards*, *Arbitral Procedure at the Dawn of the New Millennium*, Reports of the International Colloquium of CEPANI, October 15, 2004, Brussels 2005.

<sup>20</sup> Final Report on *Res Judicata* and Arbitration and Resolution No. 1/2006, Toronto Conference (2006) (Mar. 17, 2017), available at [www.ila-hq.org](http://www.ila-hq.org).

ILA recommendations concern only the arbitral awards of the international commercial arbitration and do not touch the effect of the arbitral award to the proceedings in the state court. ILA admits that to promote efficiency and finality of international commercial arbitration, arbitral awards should have conclusive and preclusive effects in further arbitral proceedings. The conclusive and preclusive effects of arbitral awards in further arbitral proceedings need not necessarily be governed by national law and may be governed by transnational rules applicable to international commercial arbitration. An arbitral award has conclusive and preclusive effects in further arbitral proceedings if:

- a) it has become final and binding in the country of origin, and there is no impediment to recognition in the country of the place of the subsequent arbitration;
- b) it has decided on or disposed of a claim for relief which is sought or is being reargued in the further arbitration proceedings;
- c) it is based upon a cause of action which is invoked in the further arbitration proceedings or which forms the basis for the subsequent arbitral proceedings; and
- d) it has been rendered between the same parties.

An arbitral award has conclusive and preclusive effects in the further arbitral proceedings as to:

- a) determinations and relief contained in its dispositive part as well as in all reasoning necessary thereto;
- b) issues of fact or law which have actually been arbitrated and determined by it, provided any such determination was essential or fundamental to the dispositive part of the arbitral award.

An arbitral award has preclusive effects in the further arbitral proceedings as to a claim, cause of action or issue of fact or law, which could have been raised, but was not, in the proceedings resulting in that award, provided that the raising of any such new claim, cause of action or new issue of fact or law amounts to procedural unfairness or abuse.

The conclusive effects of an arbitral award can be invoked in further arbitration proceedings at any time permitted under the applicable procedure. The preclusive effects of an arbitral award need not be raised on its own motion by an arbitral tribunal. If not waived, such preclusive effects should be raised as soon as possible by a party.

Although Art. III of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958) does not expressly provide that arbitral awards have *res judicata* effect, a number of national courts have ruled that it has such a consequence in practice.<sup>21</sup> For example, a United States court ruled that “though the Convention does not expressly speak to the *res judicata* effect of an international arbitral award it reflects

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<sup>21</sup> UNCITRAL Secretariat Guide on the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York: United Nations, 2016) (Mar. 13, 2017), available at [http://www.uncitral.org/pdf/english/texts/arbitration/NY-conv/2016\\_Guide\\_on\\_the\\_Convention.pdf](http://www.uncitral.org/pdf/english/texts/arbitration/NY-conv/2016_Guide_on_the_Convention.pdf). See also Gary B. Born, *International Commercial Arbitration* 3394 (2<sup>nd</sup> ed., The Hague: Kluwer Law International, 2014); Andreas Börner, *Article III in Recognition and Enforcement of Foreign Arbitral Awards: A Global*

the principle that until it is successfully challenged, an arbitral award presumptively establishes the rights and liabilities of the parties to the arbitration.”<sup>22</sup>

Art. V(1)(c) of the New York Convention establishes that recognition and enforcement of the award may be refused, at the request of the party against whom it is invoked, only if that party furnishes to the competent authority where the recognition and enforcement is sought, proof that the award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions *on matters beyond the scope of the submission to arbitration*, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, that part of the award which contains decisions on matters submitted to arbitration may be recognized and enforced. In several jurisdictions parties to arbitration have brought successful challenges to enforcement of arbitral awards under this Article because the arbitral award addressed a party that was not bound by the arbitration agreement. Several courts have therefore considered that *ratione personae* is also a “matter” within the meaning of Art. V(1)(c) and can therefore constitute a valid basis for an Art. V(1)(c) challenge to recognition or enforcement of an award.<sup>23</sup> A United States District Court denied enforcement of part of an arbitral award under Art. V(1)(c) on the basis that the arbitral tribunal had “exceeded its authority when it purported to bind a non-signatory who was not expressly covered by the arbitration agreement.”<sup>24</sup>

In some countries, courts have enforced arbitration agreements against parties that had not signed the arbitration agreement. For instance, United States courts have held that non-signatories can be bound by an arbitration agreement to the extent that the arbitration agreement is not null and void under the New York Convention and that a contract law theory – such as agency, estoppel, or principles relating to alter-egos and third party beneficiaries – applies to the case at hand.<sup>25</sup> In France, entities that had not signed the arbitration agreement have been referred to arbitration pursuant to the group of companies doctrine.<sup>26</sup>

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*Commentary on the New York Convention* (H. Kronke, P. Nacimiento et al. (eds.), The Hague: Kluwer Law International, 2010).

<sup>22</sup> *American Express Bank Ltd. v. Banco Español de Crédito S.A.*, Southern District Court of New York, United States of America, February 13, 2009, 1:06-cv-03484-RJH. See also *Gulf Petro Trading Company Inc., et al. v. Nigerian National Petroleum Corporation, et al.*, Court of Appeals, Fifth Circuit, United States of America, January 7, 2008, 06-40713.

<sup>23</sup> *Supra* note 21.

<sup>24</sup> *FIAT S.p.A. v. the Ministry of Finance and Planning of the Republic of Suriname, Suriname Rice Export Company N.V. et al. v. Alvaro N. Sardi*, District Court, Southern District of New York, United States of America, October 12, 1989, 1989 WL 122891, 4, para. 5.

<sup>25</sup> *Supra* note 21.

<sup>26</sup> *Société Kis France et autres v. Société Générale et autres*, Court of Appeal of Paris, France, October 31, 1989, 1992 Rev. Arb. 90.

When national legislation and arbitral rules<sup>27</sup> mention power or effect of an arbitral award they usually use term “binding” and especially notice that an arbitral award is binding for the parties of the arbitral agreement and dispute. Usually, case law in both common law and civil law countries recognizes that arbitral awards have the same or similar effect (*res judicata* effect). Nevertheless, such declarations in the judgment of state courts do not resolve multitude questions which arise in this field. There is no common unified rules or principles that settle such problems as 1) does an arbitral award has the same *res judicata* effect as state court decision; 2) does an arbitral award of the national arbitral tribunal has the same effect as an award of the international arbitral tribunal; 3) what law should be applied when the *res judicata* rules is employed (*lex arbitri* or *lex fori*) and others.

In Russia, the legal effect of arbitral awards of the national arbitration tribunals links only to the possibility to enforce it voluntarily.<sup>28</sup> It is useful to distinguish which effects arbitral award can have towards the litigation in state court (by the example of Russia). First, the arbitral award can be recognized and enforced by the state court by means of the state court in special proceedings (exequatur). During the process of recognition the state court examines the arbitral award and can refuse to recognize it on the grounds, established by the New York Convention. In this case, the arbitral award loses any effects. Second, an award can be set aside or suspend. Any participating party can challenge the arbitral award in the state court (Art. 230, part 2 of the ComPC, Art. 418, part 1 of the CivPC). Other persons have the right to challenge the arbitral award only if such a decision violated their rights and legitimate interests when it was decided upon their rights and obligations (Art. 4 of the ComPC, Art. 3 of the CivPC).<sup>29</sup> Third, the arbitral award has preclusive effect. The court should refuse to take action brought by the same plaintiff against the same defendant concerning the same claim, and same cause of action when preceding case was resolved by the arbitration tribunal and the final arbitral award was made.<sup>30</sup> Fourth, the court should return a claim to the plaintiff in case when the arbitral tribunal is judging the same claim of the same plaintiff against the same defendant.<sup>31</sup> It should be mentioned that procedure codes do not give the arbitral award a collateral estoppel effect, even when the triple identity test was passed.

<sup>27</sup> Art. 28(6) of the ICC Rules; Art. 26(9) of the LCIA Rules.

<sup>28</sup> Федеральный закон от 29 декабря 2015 г. № 382-ФЗ “Об арбитраже (третейском разбирательстве) в Российской Федерации,” Собрание законодательства РФ, 2016, № 1 (ч. 1), ст. 2 [Federal law No. 382-FZ of December 29, 2015. On Arbitration in the Russian Federation, Legislation Bulletin of the Russian Federation, 2016, No. 1 (part 1), Art. 2], Art. 38.

<sup>29</sup> Курочкин С.А. Государственные суды в третейском разбирательстве и международном коммерческом арбитраже [Sergey A. Kurochkin, *State Courts in Arbitration and International Arbitration*] 139 (Moscow: Wolters Kluwer, 2008).

<sup>30</sup> Art. 134 of the CivPC.

<sup>31</sup> Art. 135 of the CivPC.

### 3. The Effects of an Arbitral Award towards Non-Participating Third Parties

Two main principles prevent us from expansion binding effect of an arbitral award to any non-party – *audiatur et altera pars* and party autonomy.

In the system of current legal regulation, arbitral award does not only creates an obligation for its execution by parties participating in the arbitration proceedings but also is a ground for the execution of certain legally significant actions by other persons.<sup>32</sup>

Art. 6 of the Decision of the Constitutional Court of the Russian Federation of May 26, 2011 No. 10-P establishes that within the meaning of Arts. 1 (part 1), 2, 18, 46, 55 (part 3) and 118 of the Constitution of the Russian Federation, the state obliges to create an effective system for the protection of constitutional rights and freedoms through justice, an integral part of the normative content of the right to judicial protection, which has a universal character, is the right of interested persons, including those not involved in the case, to apply to court for the protection of their rights violated by an unjust court decision.

In accordance with the current legal regulation in Russia, in cases where an arbitral award affects rights and obligations of persons who did not participate in the arbitration proceedings, such persons have the same legal means to protect their rights, which are provided for protection of the rights of the third parties whose rights were affected by a decision of state court. First of all, they have right to bring an independent action to the competent court, as well as to challenge the arbitral award, which is beyond the scope of the private two-party dispute.

In case law of commercial courts, persons who did not participate in arbitration proceedings are considered eligible to apply to the commercial court for the protection of their rights violated or disputed as a result of the decision of the arbitral tribunal on the basis of Art. 46 of the Constitution of the Russian Federation and Art. 4, part 1 of the ComPC.<sup>33</sup>

In contrast to the decisions of state courts enforceability of the arbitral awards is vested only after exequatur proceedings. These proceedings involve checking for proper, law-based formation of the arbitral tribunal, observance of procedural guarantees of the rights of the parties and compliance with the decision of the arbitral tribunal with the fundamental principles of Russian law, i.e. for compliance

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<sup>32</sup> Постановление Конституционного Суда РФ от 26 мая 2011 г. № 10-П [Decision of the Constitutional Court of the Russian Federation No. 10-P of May 26, 2011], Art. 4 (Mar. 30, 2017), available at <https://rg.ru/2011/06/08/ksrf-dok.html>.

<sup>33</sup> Постановление Президиума Высшего Арбитражного Суда РФ от 8 декабря 2009 г. № 12523/09 [Decision of the Presidium of the Supreme Arbitration Court of the Russian Federation No. 12523/09 of December 8, 2009] (Mar. 30, 2017), available at [http://www.arbitr.ru/as/pract/post\\_pres/1\\_1\\_a269e324-0f71-4fb5-be35-c40bee123ce3.html](http://www.arbitr.ru/as/pract/post_pres/1_1_a269e324-0f71-4fb5-be35-c40bee123ce3.html).

of this private law by its nature act to those requirements that are required by law for the purposes of compulsory execution.

Such verification is carried out only by the state court (general jurisdiction or commercial) in the procedures established by the procedural legislation – Chapter 47 of the CivPC and Chapter 30 of the ComPC – for issuing an enforcement order for the enforcement of the arbitral award, and only if the arbitral award is not executed by the debtor voluntarily. At the same time, the competent court can refuse to issue the writ of execution in the cases specified in Art. 426 of the CivPC, Art. 239 of the ComPC, including if it determines that the dispute cannot be the subject of arbitration proceedings in accordance with federal law and (or) arbitration decision violates the fundamental principles of Russian law. Therefore, if the arbitral tribunal resolved the issue of the rights and obligations of persons who did not participate in the arbitration proceedings and did not give consent to it, this circumstance is the basis for refusing to issue a writ of execution for compulsory execution.

Therefore, if the arbitral tribunal resolved the issue of the rights and obligations of persons who did not participate in the arbitration and did not consent to it, this circumstance is the basis for refusing to issue the writ of execution for compulsory execution. Such arbitral award firstly, contains decisions on matters beyond the scope of the arbitration agreement, i.e. does not comply with the law, and secondly – violates the fundamental principles of Russian law, which, by virtue of Art. 46 (part 1) of the Constitution of the Russian Federation, includes the right of everyone to participate in a process that deals with questions about his rights and obligations.<sup>34</sup>

In addition, in the current mechanism of judicial control, the decision of the commercial court for the issuance of the writ of execution for the enforcement of the arbitral award, which resolved the issue of the rights and obligations of persons who are not parties to the arbitration proceedings, and thereby violated the law can be appealed directly by these persons to the arbitration court of the cassation instance in accordance with Art. 42, Art. 240, part 5 and Art. 273 of the ComPC.

Prof. Brekoulakis explained that a prior arbitral award should have *certain* preclusive and conclusive effects on related third parties, i.e. parties who have not signed the arbitration agreement nor taken part in the prior arbitration process, but who have a close contractual link to the parties in the prior arbitration because of the limited possibilities to join related parties in arbitration proceedings.<sup>35</sup> Prof. Brekoulakis agreed that a third party still would have right to bring an action in a separate arbitration against one of the parties. Also, the arbitral award cannot be enforced by or against the third party. However, a related third party should be bound in subsequent arbitration proceedings by final determinations of legal and factual issues that are common to both proceedings. It is offered to grant arbitral

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<sup>34</sup> *Supra* note 32, Art. 6.2.

<sup>35</sup> Brekoulakis 2005, at 13.

tribunals right to decide whether a related third party should be bound by the legal and factual determinations of the prior tribunal.<sup>36</sup>

This position should be partially accepted. An arbitral award can have some effect towards a third nonparticipating party. To determine this effect the comparative method could be used. Both *res judicata* and legal effect doctrines give us a variety of situations when the judicial decision would affect the right of the third party even in the case when such party did not participate in the proceedings. It is supposed that such different cases need different approach how the state court, arbitral tribunal or such third party should consider the arbitral award which affects the rights or interests of the non-participating party.

The following cases can be listed.

1. An arbitral award in it's the operative part directly stated the rights and obligation of the third party.

This is the gross violation of the principle to be heard, the idea of adversarial proceedings and the party autonomy principle. This part of the arbitral award that violates the core principles of arbitration should be considered as void. There is no need of any special proceedings to annul such award. The third party, parties, arbitral tribunals and state court should ignore such part of the arbitral award.

2. An arbitral award indirectly affect the rights and obligation of the third party in case when 1) the third party is a privy of one of the party; 2) the arbitral award is an award *in rem*; 3) the arbitral award has another effect on the rights of the third party, resulted from any substantive legal connection (including contractual one) between party of arbitration and the third party.

In these cases to guarantee the stability of arbitral award, the authority of arbitration itself, the balance of the rights of parties and non-parties in arbitration the arbitral award should have some limited effect towards non-parties. First of all, such third non-parties should consider that the rights and obligation of the parties to the dispute were established by the final arbitral award and their derivatives rights and obligation could have originated, terminated or changed. They should respect and obey such decision and further in their legal relation proceed from the assumption that the rights and obligation of the party of a dispute are the same as the arbitral award stated. It is essential to emphasize here that only question of rights, obligations, legal interests and the legal relation is accounted. The third non-party is not affected by collateral estoppel effect or any other consequences of *res judicata* or legal effect of the arbitral award. The conclusion concerning rights and obligation is what only matter here. The state court or arbitral tribunal has no right to reassert the question of rights, obligation, and interests of the parties to the primary arbitration proceedings as far as such rights and obligation was already stated by the arbitral tribunal.

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<sup>36</sup> Brekoulakis 2005, at 13.

The reasoning to such point is the following. The developing of arbitration itself follows the path of convergence of the state litigation and arbitration. There is no reason why an arbitral award should be considered as a less reliable act than the act of the state court. The legislation of most countries admits and support “private” adjudication. The New York Convention guarantees the coercive enforcement of arbitral awards without any verification of their lawfulness and reasonableness. With the aim of procedural economy, legal certainty, avoidance of parallel proceedings and conflicting decisions the binding effect of the arbitral awards towards third parties should be recognized.

From the substantive point, the rights of the third party can be derivative from the rights of the party. This dependence was originated not by the arbitral award, that only acknowledged them, but by the substantive legal relation between party and non-party. When the third party refuses to admit the binding effect of the arbitral award it at the same time negates the legal relation between him and the party.

Such point can to some extent be compared with the French law concept of “opposabilité aux tiers,” which means that a party in arbitration may have to respect an award rendered between other parties in a prior arbitration that finally decides the rights and obligations of those parties. The prior award has *res judicata* effects only between the parties to the prior arbitration. However, the parties to the prior award should be allowed to rely on the award in the subsequent arbitration against the related third party to the extent that it finally determines the legal situation between them. Conversely, the third related party should also be allowed to invoke the conclusive effects of the prior award in the subsequent arbitration against the parties to the prior award.<sup>37</sup> The application of the “opposabilité” principle seems appropriate. If a prior award finally decided the legal situation between A and B, a subsequent arbitral tribunal seized of a related dispute between A, B and C (or only A and C) should be bound by that prior award if the legal situation between A and B arises before it again as a preliminary issue. The prior tribunal had a greater interest in determining the legal situation between A and B than the subsequent tribunal. The same should apply where the legal situation between A and B was finally decided in a prior judgment.<sup>38</sup>

The third party in concerned cases should have legal instruments to protect his rights and interests. The adequate mechanism is offered by Russian case law when the third party can challenge the arbitral award in the state court. But in this case, the non-participation of the third party could not be unconditional ground to cancel the arbitral award. The third party should prove that his participation could have changed the outcome of the arbitration proceedings, which the third party can bring to the court issues and evidence that result in other decision of the arbitral tribunal.

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<sup>37</sup> Pierre Mayer, *Litispendance, connexité et chose jugée dans l'arbitrage international* in *Liber Amicorum Claude Reymond: Autour de l'arbitrage* 151 (Paris: Litec, 2004).

<sup>38</sup> Silja Schaffstein, *The Doctrine of Res Judicata Before International Commercial Arbitral Tribunals* 236 (Oxford: Oxford University Press, 2016).

It is reasonable to quote here the main reasoning of the opponents of the theory of the binding effect of an arbitral awards: 1) an arbitration proceedings are only possible between the parties involved in arbitration agreement; 2) the withdrawal of arbitration tribunal beyond the limits of the arbitration agreement is a ground reason for canceling the arbitration award; 3) arbitration awards do not prevent third parties to bring claims on the same subject or on the same and cause of action to the state courts; 4) arbitration awards do not have a collateral estoppel effect for subsequent judicial proceedings, so the third party do not constrain by the arbitral award; 5) the core of arbitration is the consent of all parties to the arbitration proceedings. This principle of arbitration, in particular, implies that the intervention of a third party is possible only with the consent of both the disputing parties and this person involved. If a third party did not participate in arbitration proceedings, it can in no way be connected with the rendered award.<sup>39</sup>

Such criticism of the idea of the binding effect of the arbitral award for the third parties do not take into consideration the following: 1) the idea of the respect to the arbitral award: the same substantive effect to the rights of all parties and non-parties should be given to the arbitral award as judicial decision has; 2) the principle of procedure economy should prevent the third party from the re-litigation of the same issues; 3) the possibility of parallel proceedings and other abuse should be excluded. It is also worth to be mention that the idea of only procedural nature of the judicial decision and arbitral award is peculiar to the modern German legal science (as the judicial decision could not have any substantive effect on the third party and such party could not have any right to challenge this decision by any means but by bringing separate special claim (Art. 772 of the German Civil Procedure Code<sup>40</sup>)).

## Conclusion

The development of private commercial relations could lead to the situation that it will be impossible to deliver an arbitral award that does not affect any third party. The complexity of the legal relations can result in the disability of arbitration itself as far as the arbitration does not have the same mechanisms of involvement of third parties.

It means that with the purpose of the possibility of arbitration, the stability of arbitral awards and legal certainty we should presume that an arbitral award can affect rights and obligations of third parties even if they do not participate in the arbitral proceedings.

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<sup>39</sup> Асосков А.В., Курзински-Сингер Е. Пределы действия судебных и третейских решений по кругу лиц, 2 Вестник ВАС РФ 108 (2012) [Anton V. Asoskov, Evgeniya Kurzinski-Singer, *The Subjective Limits of the Power of the Judicial Decisions and Arbitral Awards*, 2 Bulletin of the Supreme Arbitration Court of the Russian Federation 108 (2012)].

<sup>40</sup> Code of Civil Procedure as promulgated on December 5, 2005 (Bundesgesetzblatt (BGBl., Federal Law Gazette) I page 3202; 2006 I page 431; 2007 I page 1781), last amended by Art. 1 of the Act dated October 10, 2013 (Federal Law Gazette I page 3786).

And such third parties should “suffer” or “enjoy” such effect of “alien” arbitral award as long as they do not challenge this arbitral award in the state courts.

Moreover, we believe that the right to challenge such award should be executed in accordance with the principles of party autonomy and adversarial procedure. It means that the state court *ex officio* could not overrule the arbitral award even if it ascertains that the arbitral award affects the rights and obligation of any third party. The state court can overrule the arbitral award only if such third party itself challenge the arbitral award and in adversarial proceedings prove that his rights or obligation were affected.

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### Information about the author

**Nataliya Bocharova (Moscow, Russia)** – Associate Professor of Civil Procedure, Faculty of Law, Lomonosov Moscow State University (1 Leninskie Gory, bldg. 13–14, GSP-1, Moscow, 119991, Russia; e-mail: [practicidad@gmail.com](mailto:practicidad@gmail.com)).