

TRANSNEFT VERSUS SBERBANK: COURT OF APPEAL GIVES THE NOD TO DERIVATIVES

On 30 August 2017, the Ninth Arbitrazh Appellate Court (the "**Appellate Court**") published the full text of its decree in the case brought by PJSC Transneft ("**Transneft**") against PJSC Sberbank ("**Sberbank**") (No. A40-3903/17), in which it dismissed Transneft's claim for invalidation of FX barrier options (the "**Decree**"). The Decree is a landmark decision for the financial market, as it confirms something that until recently was in doubt: transactions with financial derivatives are subject to judicial protection in Russia. In the appellate proceedings Sberbank was represented by its legal team in conjunction with Clifford Chance.

1. SUMMARY OF THE MATTER IN DISPUTE¹

On 27 December 2013, Sberbank and Transneft entered into two FX barrier options under a Framework Agreement (the "**Disputed Transactions**")². The Disputed Transactions were a put option to sell U.S. dollars (the "**Put Option**") and a call option to buy U.S. dollars (the "**Call Option**"). The terms of the Disputed Transactions were later changed. Specifically, the barrier exchange rate for the Call Option was increased. Both the Disputed Transactions themselves and the changes to their terms were approved by the executive board of Transneft.

In the second half of 2014 the USD/RUB exchange rate rose sharply, and on 1 December 2014 the barrier exchange rate specified in the Call Option was reached. Transneft exercised the option on 21 September 2015.

On 27 December 2016, Transneft filed suit against Sberbank in the Arbitrazh Court of the City of Moscow, seeking invalidation of the Disputed Transactions

¹ This briefing is based on the text of the Decree and does not contain any assessment of the evidence submitted by the parties in the course of the legal proceedings. For a more detailed description of the matter in dispute, see our briefing *Transneft vs. Sberbank: judgment on a landmark derivatives case in Russia is published* (June 2017) (https://www.cliffordchance.com/briefings/2017/06/transneft_vs_sberbankjudgementonalandmar.html).

² The Disputed Transactions were entered into under the Framework Agreement on Derivatives Transactions on Financial Markets and the Standard Documentation for Derivatives Transactions on Financial Markets, prepared by Self-Regulated (Non-profit) Organisation National Association of Stock Market Participants (the "**NAUFOR**"), the National Foreign Exchange Association and the Association of Russian Banks.

and application of the consequences of their invalidity, in the form of bilateral restitution. By the judgment of the Arbitrazh Court of the City of Moscow (the "Court") dated 21 June 2017 (the "Judgment") the relief sought by Transneft was granted in full³.

On 23 August 2017, the Appellate Court considered Sberbank's appeal and ruled to reverse the Judgment and dismiss Transneft's claim.

2. THE APPELLATE COURT'S FINDINGS

2.1 The Disputed Transactions are valid and fully consistent with the structure of option agreements established by law

The Appellate Court found that the Disputed Transactions were valid and fully consistent with the structure of option agreements established by law. Transneft and Sberbank in equal measure determined the terms of the Disputed Transactions, as was evidenced by the correspondence between them, and the terms of the transactions were symmetrical and did not serve to create an imbalance of the parties' interests.

2.2 Sberbank acted in good faith, because it fully disclosed to Transneft the substance of the Disputed Transactions and the attendant risks, even though it had no obligation to do so

The Appellate Court found that Transneft did not present any evidence of wilful misconduct on the part of Sberbank; to the contrary, Sberbank fully, accurately and clearly disclosed to Transneft information on the terms of the Disputed Transactions and the risks associated with their performance. The Appellate Court ruled that:

- The legislation does not contain any requirement to disclose information about the risks associated with transactions with financial derivatives. At the time when the Disputed Transactions were performed there was also no customary business practice of disclosure of such information (including the NAUFOR standards)⁴;
- Despite the absence of such requirements, information about the substance of the Disputed Transactions and the risks associated with their performance was set out in detail and in full in the declaration of risks which Sberbank sent to Transneft in due time prior to the execution of the Disputed Transactions. Among other things, the declaration of risks specifically states that Transneft "*bears the risk of potentially unlimited losses*" and that Sberbank is not acting as advisor to Transneft and recommends that Transneft independently seek the requisite advice. The declaration of risks also states that it supersedes any and all previous communications between Sberbank and Transneft with respect to the Disputed Transactions.

³ For a detailed analysis of the Judgment, see our briefing *Transneft vs. Sberbank: judgment on a landmark derivatives case in Russia is published* (June 2017).

⁴ The Appellate Court found that the NAUFOR Standards invoked by the Court in the Judgment were not applicable, because they only apply to agreements involving securities of foreign issuers (Standards of Notification of Clients of the Risks Associated with Purchasing Foreign Securities and/or Entering Into Agreements Constituting Derivatives Instruments, the Underlying Asset of Which Are Securities of Foreign Issuers or Indices Calculated Using Such Securities) and to broker activities (Standards of Professional Activity on the Securities Market).

2.3 The Appellate Court found that the legislation does not contain any special requirements as to the qualifications or experience a person must possess in order to enter into transactions such as the Disputed Transactions, and also noted that Transneft in any case had experience performing similar transactions

The Appellate Court found that Federal Law No. 39-FZ of 22 April 1996 On the Securities Market (the "**Securities Market Law**") distinguishes two types of derivatives:

- "special" derivatives, intended only for "qualified investors", in relation to which the Securities Market Law establishes a special legal regime; and
- "regular" derivatives, in relation to which the legislators did not find it necessary to establish requirements on special qualifications the parties to the relevant legal relations must possess.

The Appellate Court found that the Disputed Transactions fall under the second type of derivatives, therefore there are no statutory requirements as to the qualifications or experience a person must possess in order to enter into such transactions.

The Appellate Court also noted that Transneft in any case had extensive experience with similar transactions (62 transactions with Sberbank, 102 transactions with Credit Suisse, Deutsche Bank and J.P. Morgan) and essentially met the definition of a "qualified investor".

2.4 Transneft by its actions gave Sberbank every reason to rely on the validity of the Disputed Transactions

The Appellate Court found that Transneft's conduct after the Disputed Transactions were entered into gave Sberbank every reason to rely on their validity. Specifically:

- Transneft accepted performance in the form of the premium under the Call Option and discharged the obligation to pay Sberbank the premium under the Put Option;
- Transneft, having fulfilled the Call Option, did not dispute the transaction for 3 years after the date it was performed;
- Following negotiations between Transneft and Sberbank, the terms of the Disputed Transactions were amended twice.

As a result, the Appellate Court, invoking Art. 166(5) of the Russian Civil Code, ruled that Transneft's claim for invalidation of the Disputed Transactions has no legal bearing, as Transneft had given Sberbank every reason to rely on their validity.

2.5 Based on the facts in the case, the Appellate Court ruled that Transneft's claim was time-barred

The Appellate Court found that in support of its case Transneft had essentially alleged that Sberbank failed to disclose to Transneft all necessary information about the Disputed Transactions before they were concluded.

The Appellate Court indicated that in such a situation it is not the general rules set out in Arts. 10⁵ and 168⁶ of the Russian Civil Code, invoked by Transneft, that should be applied, but rather the special rules on the invalidity of transactions concluded under influence of misrepresentation (Art. 178 Russian Civil Code) or fraud (Art. 179 Russian Civil Code).

This approach has practical implications that **may be important not only for the derivatives market, but for civil commerce in general**. Arts. 178 and 179 of the Russian Civil Code provide that transactions performed under the influence of misrepresentation or fraud are voidable, not void. Therefore, a party that is claiming misrepresentation/fraud cannot invoke the voidness of the transaction in question. The statutory limitation period for legal action to have voidable transactions ruled invalid and to have the consequences of their invalidity applied is 1 year⁷, while the statutory limitation period for claims to have the consequences of invalidity applied to a void transaction and to have such transaction declared invalid is 3 years⁸. Accordingly, the application of Arts. 178 and 179 of the Russian Civil Code instead of Arts. 10 and 168 of the Russian Civil Code may, depending on the circumstances, offer less possibility for success when bringing a claim for invalidation of a transaction.

In this case the Appellate Court found that Transneft had let the limitation period elapse.

3. CONCLUSIONS

The Decree of the Appellate Court is a notable step in the development of the derivatives market in Russia and attests to the Russian courts' adherence to the fundamental principle of the binding nature of a contract. In this case the court curtailed unscrupulous attempts to have the transactions declared invalid merely because they turned out to be disadvantageous for one party as a result of unfavourable changes in the exchange rate. The decree also contains important findings as to the performance of derivatives transactions, which participants in civil commerce should take into account.

⁵ This article contains a general prohibition against the wilful exercise of civil law rights in bad faith (abuse of rights).

⁶ This article is also of a general nature and concerns the invalidity of transactions that contravene the requirements of law.

⁷ The limitation period begins to run on the day that the violence or threat under which a transaction was performed ceases to be in effect (Art. 179(1) Russian Civil Code) or on the date when the claimant became aware or ought to have become aware of other circumstances constituting the grounds for invalidation of the transaction.

⁸ The limitation period begins to run on the day performance of the void transaction commenced.

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