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Arbitrable or Arbitrary? The Impact of Sanctions on International Arbitration

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Introduction

Events in 2022 have brought a renewed focus to the issue of sanctions and international arbitration. It is not a new issue. Over time arbitration practitioners have had to contend with a number of different sanctions regimes, including those relating to Cuba, Iran, Libya and Venezuela. However, the Russian Federation's invasion of Ukraine on 24 February 2022 and the resulting sanctions may have a far more extensive impact, given Russia's major role as a supplier of energy and commodities as well as the level of cross-border investment involving Russia in other sectors, too, such as construction, finance and manufacturing.

The international response to the invasion has been significant. The European Union, the United States and the United Kingdom, amongst others, have imposed a variety of restrictive measures targeting Russian individuals and businesses. In the immediate aftermath of the invasion, sanctions lists were being updated on an almost weekly basis as new names of individuals and entities were added. The use by States of sanctions as a foreign policy tool creates risks for businesses in general and for the lawyers advising them. This chapter considers some of the risks arising from sanctions in the context of international arbitration.

Sanctions – An Overview

Sanctions regimes can be implemented multilaterally, such as through the United Nations or the European Union, or autonomously by sovereign States under their domestic legislation. They tend to have certain features in common, as well as differences which make it imperative to check the underlying rules. In an international arbitration where one of the parties is a "designated person", it is possible for more than one sanctions regime to apply, given that parties, counsel, arbitrators and arbitral institution may be of different nationalities. Key considerations – using the UK sanctions rules as a model – include the following.

Who is sanctioned? In the case of UK sanctions, a consolidated list of designated persons is published by the relevant authority, the Office of Financial Sanctions Implementation ("OFSI"). This is a list of physical and legal persons who have been designated by a government minister under the powers conferred by the relevant legislation for a particular sanctions regime.[1] However, it is not just named persons who are sanctioned. Other persons who are owned or controlled by a designated person will also be subject to sanctions even if they are not named in the consolidated list.

What are the sanctions? A wide range of potential sanctions is available under the legislation, from asset freezes and restrictions on access to financial markets to import/export controls and travel bans. What sanctions are actually in place will depend on the particular sanctions regime in question, and who and what it is intended to target.

What is required by way of compliance? This will depend on the nature of the sanction. In the case of an asset freeze, for example, it is prohibited to deal with the frozen funds or to make funds or economic resources available to the designated person. There will also be an obligation not to engage in activity that may circumvent a sanction, as well as an obligation to make a report to OFSI.

Who must comply with the sanctions/what is their jurisdictional scope? UK sanctions apply to all legal entities and individuals, regardless of nationality, who are in or undertake activities in the UK, and to all UK citizens and legal entities wherever they are in the world.

What exemptions may be available? Exemptions to sanctions are generally limited. It may be possible, however, to apply for a licence from OFSI to carry out activity which would otherwise be prohibited. For example, in order for a sanctioned client to pay its lawyer out of funds which are subject to an asset freeze, it is possible to apply for a licence for the payment of reasonable legal fees and disbursements.

What are the penalties for breach? Possible penalties for breach of sanctions include imprisonment (up to seven years) and fines.

It will quickly be apparent that a summary such as that given above raises as many questions as it answers. For example, what are "economic resources"? What is "ownership or control"? What legal fees are "reasonable"? It is necessary to check the detail of the legislation, guidance thereto and any court decisions. Moreover, the answers to these sorts of questions and the scope of sanctions generally may differ between the sanctions law of different countries. So, for example, whilst the jurisdictional reach of UK sanctions legislation is generally limited to persons in the UK and to UK citizens and corporations in their activities abroad, some US legislation provides for the imposition of "secondary sanctions" where, in the complete absence of a US nexus, non-US persons may be targeted by asset block and denied access to US financial markets in the event of conduct such as a material violation of a sanctions programme.

Sanctions – Potential Impact on Arbitral Procedure

It can be seen that, where there is a sanctioned person amongst the participants in an international arbitration, there are numerous points at which a sanction might have an impact on the conduct of an arbitration. In the case of a financial sanction such as an asset freeze, these are the moments where payment is involved: payment of the registration fee when the request for arbitration is

filed; making an advance on account of the tribunal's and institution's fees and expenses; remuneration of counsel; and, of course, payment under the arbitral award itself. These can all be circumstances in which a licence may be required for a paying and/or a receiving party to effect the transfer of funds.[2]

Then there are the points at which other sanctions may bite; for example, a travel ban that prevents the attendance of a party or a witness at a hearing.

These obstacles may all lead to possible due process or denial of justice arguments from a litigant that finds it is unable to use the counsel of its choice, or is unable to make payment through its bank or to obtain third-party funding, or for whom the process of obtaining a licence is slow and impedes its claim or defence. Ultimately, this could lead to a party at the enforcement stage invoking New York Convention Article V(1)(b), by saying that it was unable to present its case.

In the wake of the sanctions implemented following Russia's annexation of Crimea in 2014, the International Chamber of Commerce ("ICC"), London Court of International Arbitration ("LCIA") and Stockholm Chamber of Commerce ("SCC") jointly issued a note intended to reassure the users of arbitration of the integrity of the process in the context of sanctions.[3] The arbitral institutions were at pains to stress that they remained neutral even though they were located in the EU (which had implemented sanctions). The sanctions did not directly impinge on a party's right to arbitrate. Arbitration in Europe remained open to all parties, irrespective of nationality. The main impact of the sanctions would be a certain level of additional administration for the purposes of compliance, such as checks on a party's ownership and control. In some cases, it might be necessary for a party to apply for an exemption under the regulations.

The idea that even a sanctioned party has the right to participate in legal proceedings was addressed recently by the BVI court in the context of litigation. In *JSC VTB Bank v Taruta*, the claimant bank was sanctioned. VTB's lawyers applied to the court to come off the record due to reputational concerns over being associated with a sanctioned entity. The court refused the law firm's application. Whatever the terms of the law firm's retainer, the lawyers remained officers of the court, and their duties as such outweighed the retainer terms and made their application subject to the court's discretion. These duties included maintaining the rule of law by ensuring access to the courts. The judge stressed that the sanctions regime in question was exclusively aimed at freezing assets. Save that assets were frozen, a sanctioned entity such as the bank retained all its civic rights, including full access to the courts. The fact that the bank, by being sanctioned, had acquired a pariah status did not justify its lawyers from withdrawing. It was precisely in such circumstances that the bank was in need of advice and representation: "*Even pariahs have rights.*"[4]

Arguably, the situation may not be so straightforward in international arbitration, where the tribunal is not dealing with counsel in the capacity of officers of the court, with all the attendant responsibilities. Whilst arbitral rules do contain provisions giving the tribunal powers in relation to proposed changes in a party's counsel,[5] they are more directed towards situations where, for tactical reasons, a party may seek to change its counsel at the last minute, or where the addition of new counsel might create a conflict of interests with the tribunal. It is less clear whether the power exists to override counsel's decision to recuse itself for reputational reasons (assuming such concerns are not allayed by confidentiality in the arbitration process). A tribunal may well try to deter such a course of action, particularly when it is likely to imperil the enforceability of the award.

Nevertheless, *JSC VTB Bank v Taruta* should be helpful for both arbitration and litigation as an unambiguous statement of the principle that the mere existence of sanctions *per se* should not limit a party's right to access justice.[6] Regrettably, as discussed below (*Counter-sanctions*), such principles are being rejected by some States as they respond to sanctions.

Sanctions – Effects on the Substance of a Dispute

Broadly speaking, sanctions may affect the substance of a dispute in three respects: (1) in a jurisdictional sense, as to whether a dispute where sanctions are in some way implicated is "arbitrable"; (2) on the merits and quantum, considering the effect that sanctions may have on the parties' performance under the contract and the extent of their liability; and (3) in respect of the award, where a party may raise sanctions in the context of a set-aside application or during recognition and enforcement.

As far as arbitrability is concerned, it will depend on the context in which sanctions arise. An arbitral tribunal is not able to enforce sanctions by way of imposing criminal or administrative penalties. However, a tribunal should not be prevented from making rulings as to the consequences of sanctions on a contract.[7] The arbitration agreement is, after all, an agreement separable from the main contract, so it is not automatically affected by laws which may invalidate the main contract.

As far as merits are concerned, sanctions may have effects ranging from the suspension of elements of a party's performance to the illegality of the contract as a whole. Depending on the terms of the contract and the applicable law, a party may be relying on an express sanctions clause, *force majeure*, frustration, impossibility of performance or illegality as arguments to restrict or eliminate its obligations in the light of sanctions. Even if it is possible to uphold a claim and to make a substantive award in a party's favour, the value of the award may be reduced due to sanctions. In *Ministry of Defence v IMS*, the English court held that the EU sanctions regime in question deprived the claimant of the right to recover interest for the period during which it was a sanctioned entity.[8]

Turning to the final award, the issue of sanctions may be deployed by a party seeking to oppose recognition and enforcement as being contrary to public policy further to the New York Convention Article V(2)(b), or by reference to analogous provisions of national arbitration legislation on a set-aside application. By and large, courts have become astute to limiting public policy objections to an award. More often than not, such arguments will fail. Courts are careful to establish whether the sanction has had any genuine impact on the subject matter of the dispute, or whether it is more in the way of a last resort to evade enforcement.[9] Even if the court is of the State that imposed the sanctions in the first place, this would not necessarily mean that recognition of the award would be refused.[10] This follows from a strict approach as to what constitutes "public policy" in this context. It has been held that courts "*construe the public policy limitation in the Convention very narrowly and apply it only when enforcement would violate the forum state's most basic notions of morality and justice*".[11] The foreign policy objectives of a particular State and their expression through sanctions implementation do not necessarily equate to these basic notions.

Whether the violation of a sanction will offend public policy may depend on the sanctions regime in question. There is a distinction to be drawn between multilateral sanctions regimes which command universal or widespread support, and those which are autonomous and particular to one State. So, in *SA TCM FR S.A. v NGSC*, TCM FR applied for the setting aside of an ICC award, including further to Article 1520-5° of the French Civil Procedural Code (recognition or enforcement of the award would be contrary to international public policy) on the basis that the tribunal had failed to take into account the effect of US

sanctions relating to Iran on the performance of the contract. The Paris Court of Appeal rejected the application. Unilateral US sanctions could not be considered an expression of international consensus or fundamental enough to be imported into the French conception of international public policy. By contrast, UN and EU sanctions could be considered as forming part of international public policy.[12]

Counter-sanctions

When an international crisis leads to some States imposing sanctions, it is not surprising that States whose nationals are targeted may resort to counter-measures, perhaps as a demonstration of political will or to provide support to domestic enterprises which may be suffering economically. The danger, though, is that in the cycle of recrimination and shows of strength, legal and ethical standards are wholly subordinated to politics. Two recent examples may illustrate this.

Firstly, in March 2021 the Chinese Ministry of Foreign Affairs imposed sanctions against UK individuals and entities, including – collectively – the barristers of a London chambers.[13] The sanctions were made in retaliation for Western sanctions that had been imposed on Chinese officials and, in the chambers' case, for the issue of an opinion by some members of the chambers concerning alleged human rights abuses in China. The sanctioned individuals were prohibited, amongst other things, from doing business with Chinese legal and physical persons. For those members of chambers who acted as counsel or sat as arbitrators in cases involving Chinese parties, the sanctions were liable to have a significant impact.

The imposition of sanctions directly on lawyers who act as counsel or arbitrators is a new development. It threatens internationally recognised safeguards for the conduct of legal practice, such as principles that lawyers shall (i) be able to perform their functions without intimidation or interference, (ii) not suffer sanction for action taken in the due performance of their professional duties, and (iii) not be identified with their clients' causes.[14]

Secondly, recent legislation and court practice in Russia may mean that it is now futile to arbitrate with sanctioned Russian parties unless they have assets abroad. In June 2020, a new law[15] introduced provisions into Russia's Arbitrazh Procedural Code establishing the exclusive jurisdiction of the arbitrazh (commercial) court in certain circumstances where sanctioned Russian parties are involved. There appeared to be limits to this insofar as the sanctioned party would be able to invoke the Russian court's exclusive jurisdiction in defiance of an ongoing international arbitration (and to obtain anti-suit relief against the other party) where the arbitration clause was not capable of being performed because the sanctions created an obstacle to justice. This changed, however, towards the end of 2021 with the case of *Uraltransmash v PESA*.[16] Despite the fact that the sanctioned Russian party in question had participated in the Stockholm arbitration proceedings for a number of years and was able to present its case through counsel, the Russian Supreme Court ruled that the very existence of sanctions was enough to harm the reputation of a Russian party without any additional obstacle to justice being shown. It therefore put the party at a disadvantage in the foreign forum, thus placing in doubt the guarantee of a fair trial. In such circumstances, an anti-suit/arbitration injunction could be granted.

This is a rejection of the ideas discussed above to the effect that (i) the mere fact of sanctions does not prevent access to justice, and (ii) the complications of sanctions for international arbitration lie mainly in regulatory, procedural and administrative obstacles, where compliance, due diligence and workarounds such as licences can solve the problem. According to recent Russian practice, the application of sanctions to a party means that a fair trial is not available.

It follows from this ruling that sanctioned Russian parties can ignore an international arbitration agreement and instead invoke the exclusive jurisdiction of the Russian court. Under the new law, they may request an anti-suit injunction restraining the foreign proceedings and a sum to be paid up to the amount that the other party claims in the foreign arbitration, plus court costs. Needless to say, the other party's arbitral award is not going to be enforceable in Russia.

Conclusion

It is perhaps fair to say that, in an increasingly fraught international environment, harsh measures can be imposed by States rapidly and with little regard for legal order and stability. Businesses and their advisors are caught in the sanctions crossfire. Even if exemptions and licences are available under regulations, some may decide that it is just simpler not to engage at all with certain counter-parties, rather than being exposed to risks and an evolving situation.

It remains to be seen which changes or trends will be temporary and which will be permanent. It is possible that for contracts and disputes that have an East-West dimension, even greater regard will be had to neutrality of venue, with arbitral seats that have no connection with sanctions regimes becoming more popular. Finally, whilst there may be a decline in new contracts and disputes involving parties from certain countries, sanctions themselves and the seizure of assets will generate disputes to be resolved in international arbitration.

Endnotes

1. The relevant legislation will, in many cases, be the principal UK sanctions statute, the Sanctions and Anti-Money Laundering Act 2018 ("SAMLA"), and the particular sanctions regime in the form of regulations (secondary legislation) created under it. SAMLA section 1 sets out the purposes for which sanctions regulations may be made. They include the purposes of complying with a UN obligation or another international obligation, as well as a selection of other purposes, ranging from the prevention of terrorism to the promotion of respect for democracy and the rule of law.
2. In relation to the issue of obtaining payment under an award, the case of Canadian award creditor Crystallex in its efforts to enforce a US$1.4 billion ICC award against Venezuela is instructive. At one stage, the US Treasury's Office of Foreign Assets Control ("OFAC") was refusing to provide Crystallex with a licence to carry out a judicial sale of shares in a US subsidiary of Venezuelan national oil and gas company PDVSA. In refusing the licence at that time, OFAC cited, amongst other things, prevailing foreign policy considerations: Sanderson, C. & Perry, S., "Crystallex warns of NAFTA claim against US", in *Global Arbitration Review*, Law Business Research ("*GAR*"), 24 September 2021 [accessed 25 May 2022].
3. Note entitled "[th]e potential impact of the EU sanctions against Russia on international arbitration administered by EU-based institutions", dated 17 June 2015.
4. *JSC VTB Bank v Sergey Taruta and Arrowcrest Ltd*, BVIHC (Com) 2014.0062, judgment dated 17 March 2022, at paragraphs 3–23.
5. See LCIA Rules, Article 18, and ICC Rules, Article 17.
6. Although there may be sanctions regimes that specifically deprive a party of a right of claim: see Council Regulation (EU) No. 267/2012, Article 38, and the case of *Ministry of Defence v IMS* (referred to at endnote 8 below).

7. Born, G., *International Commercial Arbitration*, 2021, Kluwer Law International, the Netherlands, 3rd ed. ("*Born – International Commercial Arbitration*"), Chapter 6, 6.04 [E], citing at footnote 321 *Partial Award in ICC Case No. 6719*, 121 J.D.I. (Clunet) 1071, 1074 (1994): "*The mere fact that the nature of the dispute may lead the arbitrator to apply various rules of law implicating public policy does not mean that the dispute becomes nonarbitrable as a result. The arbitrator must comply with the rules of international public policy, but he need not decline jurisdiction.*"
8. *Ministry of Defence and Support for Armed Forces of the Islamic Republic of Iran v International Military Services Ltd* [2019] EWHC 1994 (Comm).
9. See, for example, the decision of the Swiss Federal Tribunal in *Iranian Co Z v Swiss Co X*, Case 4A_250/2013, judgment dated 21 January 2014.
10. See the practice of some US courts in connection with US trade sanctions in relation to Iran: *Born – International Commercial Arbitration*, Chapter 26, 26.05[C][9][i](iii) and footnote 1700.
11. *MGM Prod. Group Inc. v Aeroflot Russian Airlines*, 573 F.Supp.2d 772 (S.D.N.Y. 2003) at 775, cited in *Born – International Commercial Arbitration* at Chapter 26, 26.05[C][9][i](iii) and footnote 1702.
12. *SA TCM FR S.A. (anciennement dénominée Sofregaz) v Société Natural Gas Storage Company*, Court of Appeal of Paris, 3 June 2020.
13. Ross, A., "China sanctions Essex Court Chambers", in *GAR*, 26 March 2021 [accessed 26 May 2022].
14. *UN Basic Principles on the Role of Lawyers*, Articles 16 and 18.
15. *Federal Law on the introduction of changes to the Arbitrazh Procedural Code etc.*, No. 171-FZ, dated 8 June 2020.
16. Ruling, Supreme Court, A60-36897/2020, dated 9 December 2021.

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