

The Impact of Sanctions on International Arbitration – Key Issues

Amaryllis Bernitsa

On 4 July 2023, BIICL organised a roundtable discussion on the [Impact of Sanctions on International Arbitration](#) hosted by Latham & Watkins in London. The imposition of sanctions on Russia has created numerous disputes, including disputes related to performance of contracts which contain international arbitration clauses. This has led to legal tension between legal obligations derived from U.S., EU, UK and other sanctions regimes which come into conflict with Russian counter-sanctions measures.

The speakers discussed practical issues and experiences arising from the impact of economic sanctions on international arbitration, including the impact of sanctions on international arbitration from an LCIA perspective and risks related to Russian parties avoiding arbitration clauses by bringing litigation before the Russian courts. They also covered risks related to the enforcement of Russian court judgments, the perspective from Poland and remedies under bilateral investment treaties (BITs).

In his introductory remarks, **Professor Yarik Kryvoi** of BIICL noted that after the 2022 full-scale invasion of Ukraine, Russia has become the most sanctioned country in the world. Prior to 2022, Russia imported 85% of its legal services from the G7 countries, with the UK accounting for 59% of that figure. The sanctions had a quick and profound effect on commercial and investment treaty arbitration. Many Western law firms promptly dropped all or most of their Russian clients and closed their Russian offices, arbitral institutions had to suspend proceedings involving sanctioned entities, and banks stopped processing payments. Prof Kryvoi also shared some practical insights from his recent engagements as a Russian law expert.

Charles Claypoole, Partner at the London office of Latham & Watkins, moderated the event and kicked off the discussion by explaining that over the past years there has been a conflict between obligations to act in compliance with international sanctions and obligations to perform contractual obligations. The issue has become even more complicated by: (i) the fact that sanctions regimes have increasingly become more inconsistent (for example, since Brexit, UK sanctions have been diverging from EU sanctions.); and (ii) since February 2022, different States have imposed coordinated but often inconsistent sanctions on Russia, while at the same time Russia has adopted counter-sanctions which have made it illegal for persons residing in Russia to comply with US, EU, UK and other Russia-related sanctions.

This conflict has affected contractual performance and the conduct of international arbitration in a number of ways. There is also increasing uncertainty regarding the applicability of different sanctions regimes (to the tribunal members, arbitral institutions, the parties, counsel and experts, as well as their banks); the status of sanctions laws (as a mandatory law, as part of the law of the seat, and as part of the governing law of the dispute); and the effect of Russian legislation intended to counteract the effect of sanctions on dispute resolution.

This has given rise to two important questions, namely: (i) the status of sanctions laws in the context of an arbitration, including the related questions: do they form part of mandatory law; do they form part of the law of the seat and should they be taken into account as part of the governing law of the dispute? and (ii) should Russian legislation countering the effect of international sanctions be taken into consideration?

Jackie van Haersolte-van Hof, Director General of the LCIA, spoke about the issues faced by the LCIA in the context of international arbitration. She explained that sanctions have both a practical / administrative impact on the conduct of an arbitration and a legal impact.

She noted that each arbitral institution is responsible for ensuring the promotion and achievement of sanctions' underlying goals. Each case should therefore be reviewed on its own merits. Different arbitral institutions are affected by sanctions regimes differently - for example, the LCIA as UK based is mainly affected by UK sanctions and given its caseload is particularly affected by the Russian sanctions, while the ICC is based in the EU and as to its caseload has historically been affected by cases involving Iran-related sanctions.

Jackie explained that designated persons can be both respondents and claimants. The LCIA has had a number of cases over the past couple of years involving Russian parties: both cases initiated by claimants against Russian parties who are presumably aware that those Russian parties have assets outside of Russia, and cases commenced by Russian parties because the contractual performance of their contracts has been impacted by sanctions.

Sanctions have also caused various practical / administrative payment obstacles e.g. as regards registration fees and deposits. However, the LCIA has successfully negotiated an LCIA-specific OFSI license which allows for the payment of arbitration costs.

An issue which may impact the ability to proceed relates to the correct interpretation of the OFSI rules regarding ownership and control by an asset freeze target and whether / when a party might be considered an asset freeze target by virtue of meeting the OFSI ownership and control criteria. There was initially some concern that even acting as arbitrator in a case involving an asset freeze target could be prohibited but there is now consensus that deciding a case and issuing an arbitral award would not be prohibited conduct. The main complications arise at the enforcement stage.

Alena McCorkle, Partner in the Frankfurt office of Latham & Watkins, spoke about the impact of Russian counter-sanctions on non-Russian parties participating in arbitration proceedings with Russian parties. In her experience, there are four main takeaways from Russian counter-sanctions:

- Some Russian respondents in arbitration proceedings are disregarding mandatory arbitration clauses and turning to the Russian courts instead in order to obtain judgments which are favourable to them.
- New legislation was passed in Russia in 2020 which allows Russian courts to assume jurisdiction over a dispute potentially affected by sanctions. Since then, Russian courts have been assuming jurisdiction even when the underlying agreements between the parties include mandatory arbitration clauses. The relevant jurisdictional threshold is particularly low and interpreted broadly by the Russian courts.
- Russian courts are disregarding EU and other applicable sanctions and, as a result, will likely reach different conclusions on certain questions of law.
- Russian judgments circumventing arbitration clauses may not be enforceable in the EU but they are still considered valid judgments in Russia and may be enforceable in other jurisdictions.

Mateusz Irmiński, Senior Counsel at Polish law firm Sołtysiński Kawecki & Szłzak, touched on the same topic as Alena and shared his experience advising Polish clients who have entered into contractual relationships with Russian entities. Mateusz noted that, in his experience, when Russian parties are involved in proceedings with non-Russian parties, they will either seek to take the case to the Russian courts which will assume jurisdiction, or will avoid complying with the award, which will then have to be enforced in Russia. This is inevitably problematic as a foreign award is unlikely to be enforced in Russia. Parallel proceedings and parallel rulings have been a common occurrence in those cases.

Mateusz explained that one of the biggest problems faced by Polish (and other EU) Courts at the moment is having to decide what approach to adopt with respect to those Russian judgments - should they fight with the same weapon and refuse recognition/enforcement of the judgment or should Russian judgments be recognised? Can a public policy argument be used to deny recognition?

Isuru Devendra, Senior Associate in the London office of Latham & Watkins, analysed the remedies available under BITs and treaty claims against Russian counter-sanctions. Russia is party to over 60 BITs most of which contain an Investor-State Dispute Settlement (ISDS) clause (usually UNCITRAL, SCC or ad hoc). These include BITs with several countries that Russia has designated as "unfriendly" states, including the UK, France, Germany, Spain, Switzerland, Norway, Ukraine, Singapore and Canada, although some of these BITs contain narrow ISDS clauses.

Russian counter-sanctions include recent laws on the external management of assets in Russia of persons from "unfriendly" jurisdictions. Specifically, Decree No. 302, which was issued on 25 April 2023, and relates to the temporary management of certain assets, including movable and immovable assets and equity interests in the capital of Russian legal entities. The Federal Agency for State Property Management is appointed as the temporary manager of such assets and once appointed is able to exercise all the rights of the owner of such assets, except for the disposal of the assets.

Isuru explained that Russian counter-sanctions, including measures such as Decree No. 302, could give rise to BIT claims against Russia. Potential claims available will depend on the terms of the applicable BIT and the investment protections contained therein. This will need to be assessed on a case-by-case basis. Depending on the terms of the applicable BIT and the measures taken by Russia, potential BIT claims could include:

- unlawful expropriation;
- violation of the fair and equitable treatment standard - including on the basis of arbitrary or discriminatory treatment or violation of a foreign investor's legitimate expectations;

- denial of justice;
- violation of the national treatment standard, as foreign investors are in such cases being treated differently from Russian investors in like situations;
- violation of the most favoured nation standard, on the basis that a foreign investor from "unfriendly" States has been treated less favourably than a foreign investor from another State;
- violation of the right to freely transfer funds out of Russia.

Matthew Happold, Barrister at 3 Hare Court and Professor at the University of Luxembourg, also spoke on the topic of BIT protections and noted that such protections are not guaranteed as many BITs do not include them and even if they do, some arbitral tribunals will interpret such clauses more narrowly (or widely) than others. Given that BITs are reciprocal, such protections could be relied on in the same way by Russian nationals who bring claims under the relevant BITs.

Matthew highlighted two main concerns in this area:

- EU regulations relating to asset freeze sanctions always include a "no claims" provision which states that the designated person cannot bring claims in connection with any contract or transaction the performance of which has been affected by EU sanctions. An argument could be made that this provision constitutes a denial of justice.
- The legality of sanctions: there is disagreement regarding whether states can justify the imposition of sanctions. Even though national courts try to stay away from this topic, arbitral tribunals may want to dig deeper into this question. This topic is expected to become even more prominent in light of various recent proposals to move from freezing assets to seizing them.

Author:

Amaryllis Bernitsa, Associate, Latham & Watkins LLP, London

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