Kluwer Arbitration Blog

The Challenge of Sanctions for Arbitral Participants

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Financial, trade and political sanctions have long been used by states as a tool of foreign policy. This is no less true today, where high profile sanctions regimes have been imposed against Iran, Myanmar, Sudan, North Korea, and Zimbabwe amongst many others. See, for example, the lists of sanctions maintained by the EU (see here), USA (see here) and Canada (see here). Such sanctions of course indirectly affect those outside the target jurisdictions in question, as any overseas company attempting to do business in such a country knows only too well.

But with the imposition and tightening of sanctions imposed against certain Russian individuals, organisations and industries by countries including the United States, Japan, and the EU, the effect of sanctions on the arbitral process and its participants has shot up the agenda. In fact, in the case of the Russian sanctions, the visible impact on arbitration – the subject of this post – was amplified by the sheer number of Russian parties and foreign investors who had already agreed to contracts using (1) foreign governing law, (2) foreign seated arbitration clauses, and (3) the use of offshore companies.

Sanctions as a Question of Contract Law

Sanctions may, depending on their content and the contract's governing law, trigger certain provisions (e.g. force majeure) and/or see the invocation of doctrines including frustration. But the legal effect of sanctions can also be set out, at least in part, in their very text. For example, the EU sanctions against Russia do not:

- allow parties to excuse themselves from the performance of their contractual obligations (see Article 2(5), EU Council Decision 2014/145/CFSP);
- entitle parties to claim compensation where contractual performance is suspended or terminated as a result of the sanctions (see Article 11(1), EU Regulation 833/2014); or
- prohibit a party from seeking juridical review of whether the non-performance of contractual obligations was in accordance with the sanction (see Article 11(3), EU Regulation 833/2014).

While beyond the scope of this post, it bears noting that the impact of sanctions on pre-existing contracts is an area that, as recently as 2014, was described by one scholar as having "seldom been explored" (see Mercédeh Azeredo da Silveira, Trade Sanctions and International Sales: An Inquiry into International Arbitration and Commercial Litigation, (Kluwer Law International 2014), p. 1). Analysing this area is a central challenge for counsel, parties, and arbitrators to face once the plethora of process and procedure challenges identified below have been addressed.

The Impact on Parties

The initial impact of sanctions on parties is often easy to ascertain: directly or indirectly, the sanctions have made performance of the contract difficult, unprofitable, or impossible.

A party seeking arbitration of such a dispute may be required by an arbitral institution to provide additional information beyond that normally required. The International Chamber of Commerce ("ICC"), for example, may call on parties to submit additional information where:

- one of the parties is listed by a sanctions regime;
- one of the related entities is listed by a sanctions regime;
- the subject matter of the dispute itself falls within a sanctions regime; or
- the parties want to nominate an arbitrator, mediator or expert from a sanctioned country.

There may also be an obligation on parties to provide information prior to submitting a request for arbitration if they have any doubts concerning the application of sanctions, in particular information:

- concerning the identity of the parties with additional information regarding ultimate beneficial ownership;
- concerning the identity of all related entities in the dispute between the parties; and
- additional information regarding ultimate beneficial ownership.

Where the ultimate beneficial owner or the immediate party is a designated target of sanctions, or where the party trades in military or dual-use goods, regulations on the freezing of assets and financial sanctions may apply.

In addition to negatively impacting the practical ability to commence or participate in proceedings, such designated targets of sanctions may face significant practical challenges in terms of being able to attend and participate in hearings. As noted in the recent joint article issued by the ICC, LCIA and SCC on the potential impact of the EU sanctions against Russia on international arbitration administered by EU-based institutions, parties faced with this situation would need to apply to the relevant authority for one or more exemptions under the relevant regulations.

This situation may be particularly complicated in multiparty contract and joint venture ("JV") situations where (1) only one of several parties to the contract or JV is the subject of sanctions, or (2) there are various JV members responsible for funding the arbitration (or who stand to gain from an award), even if not direct parties to the arbitration.

The Impact on Arbitral Institutions

Anecdotal evidence suggests that the time needed to comply with such requirements and for an arbitral institution to examine and address its own exposure to sanctions regimes can be significant. Thus parties may face many months of delay arising from the arbitral institutions' process, particularly where the content of sanctions or control of entities materially change over time. Moreover, and as expressly noted by the ICC in information related to international sanctions on its website, where the services of commercial banks are required in support of arbitration, such banks may also require formal clearance by relevant authorities prior to making payments to or receiving payments from the parties, arbitrators, experts, and arbitral institution in question.

Yet the single greatest impact of sanctions on arbitral institutions might be – as appears to be the case for Russian sanctions – potential harm done to their image as neutral, effective, and independent administrative institutions. It is perhaps for this reason that the ICC, the LCIA and SCC issued the joint article referred to above, promoting their ongoing capabilities in administrating arbitrations involving Russian parties.

The article notes that the sanctions do not preclude Russian parties from referring disputes to EU-based arbitral institutions, and that "it is very much business as usual", albeit with some additional administrative steps if a party is a sanctioned individual or entity. Despite these efforts, there is some anecdotal evidence of a shift in parties' practice. Certain Russian parties and their foreign counterparties are seeking alternative places of arbitration which have not imposed sanctions on Russia (as discussed in HSF's blog post, here) and the extent to which this shift is occurring will only become clearer in time as newly concluded contracts reflect this approach.

The Impact on Tribunals

Tribunals may also face concerns as to their impartiality and independence. A poll conducted at a recent arbitration conference in Moscow reportedly found that Russian users of international arbitration are concerned less about the arbitral institutions themselves and more about a perceived change in the attitude of European arbitrators. This appears to stem in part from a concern that arbitrators from, or resident in, countries that have imposed sanctions are more likely to take sanctions into account, even when the dispute is adjudged by the law of a non-sanctioning state or where the seat of the arbitration is located in such a state.

To the extent that arbitrators decline to act in sanctions-related disputes or disputes involving designated targets (perhaps fearing personal liability under their national law or the law of the seat, which may criminalise breaches of sanctions), the dispute resolution process will be slowed and complicated. This is true too of arbitrators from states targeted by sanctions, who may be wary of issuing an award contrary to their home state's law, or in compliance with foreign sanctions, or who may fear interference from their home state's courts.

Enforcement of Awards

A final and significant challenge is the enforcement of awards, regardless of where the arbitration was seated.

Under the UNCITRAL Model Law, adopted by many states, one of the grounds for setting aside an arbitral award is contradiction of a state's public policy. Similarly, Article V(2)(b) of the New York Convention allows a court to refuse enforcement of an award on the basis of public policy. Therefore, if an award effectively circumvents sanctions it may well not be enforceable in a country that has imposed them. On the other hand, if an award is sought to be enforced in a sanctioned state, such as Russia, a court of that state may (or may not) set aside, or refuse to enforce, the award by reference to sanctions. This suggests too that the boundaries of the common law maxim "equity does not act in vain" appear increasingly likely to be tested. Tribunals are likely to be concerned by the challenges that sanctions bring and struggle to craft remedies which are both just and meaningful.

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