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Hong Kong Emerges as Russia's Refuge while the EU's Sanctions Cripple Major Russian Businesses

Olga Boltenko (Fangda Partners) · Monday, November 24th, 2014

Numerous commentators have reported on the sanctions war in the past. What remains to see is how the sanctions war affects the Russia-related arbitration geography.

On 8 September 2014, the European Union introduced a new set of sanctions on major Russian companies and wealthy individuals. The sanctions came following Russia's annexation of Crimea and its involvement with large-scale military operations in the East of the Ukraine. In the EU Council parlance, the sanctions comprise "*restrictive measures in respect of actions undermining or threatening the territorial integrity, sovereignty and independence of Ukraine*", and they are imposed "*in view of Russia's actions destabilizing the situation in Ukraine*". The latest round of sanctions is meant to target "*individuals or entities conducting transactions with the separatist groups in the Donbass region of Ukraine*".

The sanctions include "*freezing of funds and economic resources*" of those said to be responsible for or contributing to Ukraine's destabilization. Most importantly, the sanctions target Russia's oil and gas industry and provide for restrictions "*on the sale, supply, transfer or export, directly or indirectly, of certain technologies for the oil industry in Russia*".

The expanded list of sanctioned companies includes mostly arms manufacturing businesses and military equipment traders, but it also targets Russia's oil and gas giants GazpromNeft, TransNeft, and Rosneft, among other companies and industries. The expanded sanctions make it extremely difficult for the sanctioned oil and gas conglomerates and their subsidiaries to cooperate with their EU counter-parts. This will particularly hinder the provision of the future services necessary for deep water oil exploration and production, arctic oil exploration and production, and shale projects in Russia.

In response to the EU sanctions, in what seems to be an outburst of indignation, Rosneft announced on 30 October 2014 that it will not arbitrate its future disputes in jurisdictions that have sanctioned Russian businesses and individuals. For the record, those jurisdictions include not only all EU member-states, but also Canada, Japan, Norway, and Australia. But Russians don't do anything by halves. Rosneft also urged the Russian legislature to prohibit, on a statutory level, selecting the law of the sanctioning jurisdictions to govern Russian foreign transactions with, presumably, the world. Rosneft also suggested that Russia abolish a number of its international treaties for fear of partiality of the "*Western world*".

The impact of the sanctions war on arbitration involving Russian parties is immense. The sanctions war has allegedly brought into question Russia's use of major European arbitral institutions, such as the SCC, the LCIA, the ICC, the VIAC, and others. If Rosneft, for example, is to arbitrate its future disputes in Stockholm under the SCC rules, while the sanctions are becoming exponentially more severe, will the SCC Secretariat be in a position to request that Rosneft pay its share of the deposit into the SCC accounts in Stockholm? If Rosneft is to resort to administered arbitration services under the institutional rules of the European institutions, will those institutions be in a position to offer those services? But, it is not only that. It has been reported elsewhere that arbitrators of certain nationalities might have to resign from disputes involving Russia's sanctioned companies and individuals.

Against the backdrop of the sanctions war, and the way it impacts the sanctioned companies' dispute resolution options, the East looks relatively welcoming and sanction-free to major Russian businesses.

That being said, Russian businesses are familiar with operating in dictatorial and quasi-dictatorial regimes, and they appear wary of those regimes. In China, for example, Russian companies will have to deal with the "Four Difficulties" when it comes to enforcement: (1) the difficulty to find the defendant; (2) the difficulty to find the property against which to enforce; (3) the difficulty to take action against such property; and (4) the difficulty to find the authorities to assist with enforcement. Another China-specific risk is that the Supreme People's Court may set aside an award if it violates the "Four Fundamental Principles of China", in addition to more conventional grounds. Those Four Fundamental Principles comprise the following (1) to adhere to the socialist road; (2) to adhere to the people's democratic dictatorship, (3) to adhere to the leadership of the Communist Party, and (4) to adhere to Marxism-Leninism and Mao's thought.

Many other popular Asian arbitration jurisdictions are certainly very appealing to Russia at the moment given their developed arbitration laws, relative political stability, experienced judges, excellent venues and other arbitration-related infrastructure. However, the fear of having to arbitrate against those states and their state-owned companies and the fear of having to subject those disputes to local judges still remains.

In Asia, among the non-sanctioning jurisdictions, Hong Kong stands out as perhaps one of the most neutral arbitration seats. It benefits from the "*one country, two systems*" protection mechanism against the "*home town justice*". Prominent common law judges sit on Hong Kong's Court of Final Appeal. Hong Kong has a track-record of enforcing awards against Chinese state-owned companies. Ms. Valentina Matvienko, the speaker of the Federation Council of Russia, mentioned during her recent trip to Hong Kong that Hong Kong offers the benefits of a sophisticated common law jurisdiction just like the UK, but it is less politicized. For this reason, among others, the Russian government encourages Russian businesses to consider Hong Kong for their operations.

Russian giants that move to China may not necessarily agree to seat their disputes in mainland China, and their Chinese counterparts may equally be reticent to subject their disputes to the supervision of Russian courts. Therefore, Hong Kong is a natural middle ground, and is well prepared for the influx of Russian-Chinese disputes. Last week the Hong Kong International Arbitration Centre unveiled a Russian translation of its 2013 Administered Arbitration Rules. This is a welcome addition to the Chinese, Spanish, Portuguese, Japanese, and Korean versions of the Rules already in place. The HKIAC's panel of arbitrators and its list of arbitrators contain hundreds

of arbitrators who are not affected by the sanctions war. The HKIAC's Secretariat now offers secretarial services to arbitral tribunals, which is an important feature for the Russian and Chinese disputing parties who are used to heavily administered arbitrations. The HKIAC has also recently amended its model clause now recommending that the parties select the law to govern their arbitration agreements, which preempted Rosneft's dilemma by at least half a year.

Finally, Russians travelling to Hong Kong to attend arbitration hearings or to consult with their Hong Kong based lawyers do not need to apply for entry visas, as is the case when they have to travel to the European Union, Canada, Australia, Japan, Singapore, and many other traditional arbitration jurisdictions. Hong Kong conveniently offers visas on arrival.

These recent developments would seem to suggest that Hong Kong will see a marked increase in Russian-Chinese disputes in the years to come, turning the city-state into a forum where the Russian Bear meets the Chinese Dragon.


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