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Sanctions vis-à-vis Blocking Measures and the Dilemma Faced by Arbitral Tribunals: Lessons Drawn From EU Blocking Regulation and U.S Extraterritorial Sanctions

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Introduction

The United States announced the reinstatement of sanctions on Iran in May 2018. Following that, the EU responded by revising their Blocking Regulation (Regulation 2271/96) in August 2018. The Blocking Regulation was designed to safeguard European entities from the extraterritorial reach of the U.S. sanctions. The uncertainty surrounding the scope of application and the nature of blocking regulations, in general, has left their role in arbitration open to increasing speculation.

In Section I below, we discuss secondary sanctions, with a focus on the recent extraterritorial sanctions imposed by the U.S. In Section II, we analyze the varying nuances of blocking regulations and their implications on arbitration, considering EU Blocking Regulations as our focal point. In Section III, we address issues arising when a dispute falls both within the ambit of extraterritorial sanctions and the purview of blocking regulations. Finally, in Section IV, we provide an overview of the comprehensive analysis to be undertaken by arbitrators when confronted by a dispute that involves blocking regulations and extraterritorial sanctions.

I. Secondary Sanctions

Sanctions often have a wide and horizontal application prohibiting commercial activity with regards to an entire country. There are two categories of sanctions which may be imposed by a country: primary sanctions and secondary sanctions. Primary sanctions are those sanctions which are imposed on actions having a jurisdictional nexus with the country imposing them. Secondary sanctions apply to international parties without any relevant jurisdictional nexus between those parties and the country imposing such sanctions.

For the purpose of this post, we will focus on secondary sanctions which are extraterritorial in nature. In essence, these sanctions assert jurisdiction over a foreign party often without substantial nexus between the entity or the act committed and the territory of the regulating states. The extraterritoriality of sanctions is not generally accepted across all jurisdictions and hence states may develop blocking regulations to combat these sanctions. For instance, the U.S. imposed secondary sanctions and the EU developed Blocking Regulations to combat the same. This has

been precisely echoed in the preamble of the EU Blocking Regulation which recalls that “by their extra-territorial application, such laws, regulations, and other legislative instrument violate international law and impede smooth international trade”.

II. Blocking Regulations

A. What are Blocking Regulations?

A blocking regulation is the legislation adopted to impede the sanctions imposed by a foreign jurisdiction.Blocking regulations are not a new phenomenon; Canada and Mexico implemented blocking regulations to counter the effect of U.S. sanctions in 1992 and 1996 respectively. A blocking regulation shields companies and individuals within its jurisdiction by prohibiting them from complying with sanctions, and not abiding foreign court rulings, orders and awards. These regulations can serve an important role as part of the legal measures employed by governments whose citizens will be subject to the sanction and can protect their commercial activities from the consequences of snapback.

B. Implications of EU Blocking Regulation (Regulation 2271/96)

The EU Blocking Regulation is not a standalone measure and each EU Member State ought to determine the amount of the penalty it deems appropriate to impose through their domestic legislation. For example, under German law, breach of the EU Blocking Regulation may constitute an administrative offence and can result in a fine of up to 500 Euros.

It is widely understood that the EU Blocking Regulation has neither been heavily enforced nor tested so far. At the EU level, no jurisprudence exists currently, except the one enforcement action has been heavily reported – against BAWAG PSK.

There are two major intended impacts of the EU Blocking Regulation: first, to enable foregoing compliance with any requirement of prohibition stipulated in extraterritorial sanction and, second, the nullification of foreign decisions. They both bear an important implication as they are changing the way arbitrators resolve disputes as the arbitrators are confronted with another applicable law.

III. The Impact of Secondary Sanctions and Blocking Regulations on International Arbitration

A. Impact of Secondary Sanctions

The impact of sanctions with extraterritorial reach can be summarized in four distinctive categories:

1. as a part of the governing law to the merits of the case: Parties may use sanctions as an excuse for failure to comply with contractual obligations. It may be either treated as ‘force majeure’ or ‘frustration of purpose’ depending on the jurisdiction.
2. as a part of the domestic law of the lex arbitri or seat of the arbitration: Sanctions may form a part of the applicable law to the dispute if the seat of arbitration is situated in a sanctioning country.

For example, if the parties have chosen New York as their seat of arbitration, U.S. sanctions will be applicable to the dispute.

3. at the enforcement stage: The impact of sanctions continues even after an arbitration is concluded and an award issued, that is in the context of enforcement. Where enforcement is sought in a sanctioned state, an award may be subject to a challenge in the enforcing court if the objections raised concern a violation of sanctions regulations.
4. external effect: Secondary sanctions usually result in impossibility of performance of a contract thereby releasing the obligation to perform. However, from a dispute resolution perspective, when a sanction regime proclaims itself applicable extraterritorially, it does not necessarily imply that arbitral tribunals, or domestic courts will give extraterritorial effect to these sanctions.

In this regard, characterization of sanctions by arbitrators has an important impact on an arbitration proceeding. There is no consensus yet as to whether sanctions should be given effect as fact or law. A factual impediment occurs whenever a sanction has the power to compel an individual or an entity to withhold performance, usually via threats of enforcement measures or penalties. The factual approach is increasingly regarded as an unsatisfactory shortcut to the extent that it compels arbitrators to give effect to sanctions almost mechanically which in reality contradicts the purpose of party autonomy. The legal approach suggests that a sanction would be given effect either only because it forms part of the applicable law or because it is applicable as a foreign overriding mandatory rule. It is important to note that the legal approach guarantees a higher degree of flexibility and allows the arbitrators to take into consideration blocking measures.

B. Impact of Blocking Regulations

A blocking regulation, in general, does not automatically apply to an arbitration proceeding, unless it aims to counter a sanction, and its application on the arbitration proceeding cannot be scrutinized in isolation.

The gradual promulgation of blocking measures into domestic law of the parties could result in a concrete body of law enabling courts to openly enforce blocking measures. By such adoption, these measures would fall within the ambit of article 9 of the Rome Regulation and constitute a part of the public policy of the seat of arbitration and be of significance at different phases of the arbitral procedure.

A major impact of the EU Blocking Regulations on international arbitration is the nullification of the effect of any foreign decision including court rulings or arbitration awards, based on the listed extraterritorial legislation or the acts and provisions adopted pursuant to them. This simply means that a European court ought to refuse to enforce an award for the reason that it contravenes EU Blocking Regulations.

IV. The Irreconcilable Dilemma Faced by Arbitral Tribunals

The dearth of jurisprudence with regards to blocking regulations has left many pertinent issues unanswered regarding how disputes involving sanctions and sanctioned parties vis-à-vis blocking regulation should be resolved. As previously mentioned, firstly, blocking regulations have a direct bearing on the enforcement of an arbitral award; secondly, arbitrators may engage in an excessive conflict of law analysis to determine and rationalize the applicable law; and, finally, in some particular situations, arbitrators may face certain liabilities due to breaching sanctions regime or

blocking regulations.

One of the key operative provisions of EU Blocking Regulations seeks to nullify the effect of any arbitration award based on the sanction regime. Similarly, if the adoption of the blocking regulation is regarded a public policy pronouncement embedded in substantive law of a country, parties may seek to resist enforcement of such awards by arguing that the arbitration award is inconsistent with the country's public policy. The recognition or enforcement of an arbitral award that involves sanctions may sometimes be seen as contrary to public policy in a sanctioned country. The generally restrictive view of public policy expressed in the famous case *Westacre vs. Jugoimport-SDRP* demonstrates that the courts, not taking into account unilateral sanctions that do not amount to public policy, will not be breaching 'international public policy'. The judgment confirms that the prevailing trends with respect to the notion of public policy is in favor of international public policy.

The interplay of blocking regulations and sanctions calls for an extensive conflict of laws analysis while simultaneously broadening the discretion of arbitrators to apply the most appropriate law. When a disputed transaction falls within the ambit of both an extraterritorial sanction and blocking statutes, it is crucial for arbitrators to weigh the interests that are served by the sanctions against those served by the blocking statutes to determine which one should be applied to the dispute. The question that arbitrators need to consider is whether to look at a blocking regulation that has already declared the sanction unlawful or use their discretion to analyze the merits of the case. Furthermore, arbitrators must examine whether sanctions serve interests that are deemed legitimate by the international community. Thus, if a sanction is evidently based on discriminatory motives, arbitrators have the authority and a duty to disregard it.

While blocking regulations have put arbitrators in a precarious position, this post puts forward that endorsing conflict of laws analysis by arbitrators in order to rationalize applicable law could be perceived as an ideal way to maintain the predictability of the arbitration proceeding. The conflict of laws analysis may grant tribunals an objective criterion to take into consideration blocking regulation without disregarding the parties' choice of law and exceeding its designated power. Moreover, applying conflict of law rules will play an important role in the absence of applicable law or where the parties have not chosen a law, and the result will be much more predictable.

An arbitrator may unknowingly breach sanctions and be held liable in certain cases when they are unsure of whether they can rely on blocking regulations or whether taking sanctions into account may expose them to violation liability. As the legal character of blocking regulations eventually gains uniformity, the aforementioned concerns need to be addressed by the arbitration community. If the landscape remains ambiguous, only the future will tell if arbitration remains to be the chosen form of cross-border dispute resolution.

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