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Is There Room for Sanctions in Public Policy? Opposite Approaches in The Recent Case Law of the Ukrainian Supreme Court

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We live in time when sanctions hit the headlines almost every quarter. Naturally, this frustrates contracts and creates additional causes for disputes. However, there exists uncertainty as to whether sanctions also render awards unenforceable on the grounds of public policy. As will be shown in this post, even within the supreme court of one country the understanding of public policy can change within a period of a month.

Both cases discussed in this post concern two similar awards of the International Commercial Arbitration Court at the Russian Chamber of Commerce and Industry (ICAC), according to which advance payments under identical sales agreements were recovered from a state company "Artem" (Ukraine) in favor of Avia-Fed Service (Russia). The sales agreements stipulated that Artem shall supply Avia-Fed Service with goods of military nature that were to be distributed further to Russian defense industry companies. These Russian companies were subsequently included on the Ukrainian sanctions list, which is why the delivery never happened. The ICAC panel of arbitrators upheld Avia-Fed Service's claims for the recovery of the advance payments and Avia-Fed Service subsequently filed motions with the Ukrainian state court to enforce the ICAC awards.

First approach: sanctions do not render awards unenforceable

According to the Judgment of the Ukrainian Supreme Court dated 9 January 2020, case No. 761/46285/16-C, sanctions are not part of public policy and the enforcement of awards may not be subjected to them. In this case, the Ukrainian Supreme Court initially annulled the lower courts' decisions not to enforce the first ICAC award on the grounds of public policy (Judgment of the Shevchenkivskiy district court dated 31 May 2017 and Judgment of the Kyiv appellate court dated 8 November 2017, case No. 761/46285/16-c). The Ukrainian Supreme Court remanded the case for the retrial, despite Artem's arguments that sanctions shall preclude the enforcement. According to the Ukrainian Supreme Court, "*the mere fact, that the claimant is a Russian company, with Russia being an aggressor-state, is not a proper ground for the failure to perform obligations.*" (Judgment of the Ukrainian Supreme Court dated 5 September 2018, case No. 761/46285/16-c).

In the retrial, the court of the first instance decided that sanctions do not render the award unenforceable but stated that actual enforcement proceedings may be put on hold, since Avia-Fed

Service had already been included on the sanctions list by then (Judgment of the Shevchenkivskiy district court dated 6 December 2018, case No. 761/46285/16-c). The court noted in this regard that "*suspension of the performance of the economic and financial obligations may be applied at the enforcement proceedings stage and may not serve as grounds to reject the motion to enforce the award"*.

The court of appeal subsequently confirmed that sanctions do not constitute a basis to deny enforcement: "*the mere fact that the claimant is put on the [sanctions] list (…) does not mean that the enforcement of the ICAC award (…) will violate Ukrainian public order, as the award concerns only private relations between the commercial entities in relation to the performance of a contract they have entered into"* (Judgment of the Kyiv appellate court dated 12 June 2019, case No. 761/46285/16-c).

The Ukrainian Supreme Court has confirmed the correctness of this approach in its Judgment dated 9 January 2020. The courts' reasoning was based on that fact that Ukrainian law introduced special mechanisms to put on hold the enforcement proceedings by means of Ukrainian Law No. 2508-VIII dated 12 July 2018 ("**Law No. 2508**").

Art. 2.1 of the Law No. 2508 prohibits the recovery of debt in enforcement proceedings against Ukrainian strategical defense companies (which is the case of Artem) in favor of companies established in the aggressor-state (such as Russia). Art. 35 of the Ukrainian "Law on Enforcement proceedings" provides that the enforcement proceedings shall be put on hold, until the grounds for application of Art. 2.1. of the Law No. 2508 disappear.

In other words, the courts confirmed that Ukrainian law, allowing for the recognition of the award, protects the sanctions regime by means of singular rules of temporary nature. Therefore, the court refused to use public policy defence as a shelter for sanctions at the judicial enforcement of the award stage.

Second approach: sanctions are a new element of public policy

Following a mass-media campaign blaming judges of the Ukrainian Supreme Court for alleged sabotage (e.g. https://www.youtube.com/watch?v=IJ_pTqVJwms), in the course of some five weeks the Ukrainian Supreme Court has diametrically changed its position.

In its Judgment of 13 February 2020 in case No. 824/100/19, the Ukrainian Supreme Court overturned the decisions of the lower court on enforcement of the second ICAC award and found that "*sanctions represent one of the new aspects of the public policy in Ukraine*". Despite the Supreme Court's findings in the previous judgment, it now concluded that enforcement of awards is not a matter of the enforcement proceedings but has to be dealt with in court, rather than by the enforcement authorities, which is why the second ICAC award may not be enforced until the sanctions have been lifted.

The Court particularly considered that the subject matter of the sales agreement were military goods, due to which it found that return of advance payments may potentially be used for the purposes of strengthening of the Russian military system. The court found that such possible application of the disputed amounts would be disadvantageous to the Ukrainian military industry as well as detrimental for the security of the Ukrainian people.

The Ukrainian Supreme Court, nevertheless, mentioned that after the sanctions have been lifted, Avia-Fed Service may try to enforce the award again. However, the Ukrainian Supreme Court failed to explain the procedural basis for such subsequent application: namely, operation of the res judicata effect and expiration of procedural limitations for enforcement.

Comparison of the two approaches

Being less detrimental to the commercial expectations of the parties, the approach of the Ukrainian Supreme Court outlined in its 9 January 2020 Judgment appears to be better-grounded.

Firstly, sanctions are measures of only temporary restrictive nature caused by the current political situation, whereas public policy is generally understood as fundamental and basic legal principles. Sanctions may be lifted at any time, whereas fundamental principles of the state and society do not change so fast. In other words, public policy is a stable category, which is not that easily susceptible to political changes.

Secondly, inserting sanctions into the notion of public policy may cause undue influence of the executive branch of power towards the judicial since sanctions are usually introduced by acts of the executive branch of power. In this scenario, in order to avoid enforcement of an award against, for example, a state-owned entity (or even a state itself), it would be sufficient to make sure that the claimant is put on a sanctions list.

Thirdly, a denial of the enforcement of the award results in res judicata. If sanctions are lifted after the appeal period it may already be impossible for the claimant to avoid the res judicata effect and try to enforce the award a second time. Moreover, procedural limitations of the enforceability of the award may expire by the time the sanctions are lifted. There is no good reason to make private parties that vulnerable to the fast-changing political situation.

Fourthly, the 13 February 2020 approach, according to which the mere possibility that the awarded money may contribute to the Russian defence industry suffices for the application of public policy, seems to also be dangerous as it may potentially be broadly used in relation to any Russian entity.

In contrast, it makes sense to put the enforcement proceedings on hold during the sanctions period between the states (e.g. when the bank transfer is technically impossible) and resume them as soon as the sanctions are lifted, without causing neither adversarial res judicata effect nor expiration of procedural limitations for the enforcement. This approach allows more flexibility and affects commercial expectations of the private parties less.

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