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The Arbitrability of Secondary Sanctions: A System with a Coherent Standard of Review

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In January 2020, following the Executive Order of President Trump, the United States imposed additional sanctions targeting predominately Iran's metals sector including copper, iron and steel manufactures (the "Order"). These sanctions were designed to expand secondary sanctions to cover new industry sectors such as mining, textiles and construction. The secondary sanctions aim to deter and penalize non-U.S. individuals and entities who knowingly engaged in a "significant transaction" for the sale or transfer of Iranian goods in connection with those sectors. In effect, the Order also imposes criminal sanctions against third-country actors for engaging in activities, like financial and technological support of Iranian parties that may not have a U.S. nexus. For instance, U.S. secondary sanctions threaten to bar non-U.S. entities, such as European businesses, from foreign exchange transactions subject to U.S. jurisdiction, or to deny certain loans from U.S. financial institutions. Such extra-territorial reach of jurisdiction may cause many contracts between Iranian entities and non-U.S. entities to become inoperative. To this effect, the recent imposition of sanctions on Iran brings into focus the suitability of international arbitration as a mechanism to resolve disputes arising out of secondary sanctions.

Traditionally, sanction-related disputes have been regarded as non-arbitrable, because sanction provisions (both primary and secondary) are a function of foreign policy and would usually fall within the ambit of the international public policy concept. However, the existing paradigm reveals an opportunity for arbitration to resolve disputes concerning secondary sanctions.

This blog post discusses the aptitude of international arbitration as a transnational system of justice by examining the validity and application of secondary sanctions. In doing so, it addresses the interplay between the arbitrability of disputes and the public policy exception. It then discusses how international arbitration endorses international law to assess the validity of sanctions. Finally, it concludes with why international arbitration can adequately adjudicate disputes involving secondary sanctions.

The Legal Nature of Secondary Sanctions

Secondary sanctions are increasingly a substantive topic for consideration in international arbitration, where arbitrators must decide whether sanction policies are relevant to the merits of a party's performance of a contract. Yet, the first question an arbitrator must address is whether a

dispute is capable of being arbitrated in the first place. The answer to this question very much depends on whether sanction regimes are characterized as involving "overriding mandatory provisions" of the *lex arbitri* or whether they fall under the category of "public policy" of the country that imposed sanctions. This distinction is important because, although the contours of overriding mandatory provisions and public policy are not well-defined, not all the rules of public policy necessarily override mandatory provisions. In this respect, overriding mandatory rules cannot be derogated, and their application is compulsory irrespective of the law otherwise applicable. Accordingly, Article 9(3) of the Rome 1 Regulation of the Rome Convention ("Rome Regulation") provides a possible source of guidance. Based on this provision, overriding mandatory rules are related to social and economic policies of the relevant country, serving its crucial public interest, without regard to private law norms. However, it must be recognized that the definition of an overriding mandatory rule has its roots in private international law, which is predicated on the notion of forum verses foreign law. To this end, provisions enshrined in the Rome Regulation, which is a private international law instrument, are intended to mitigate jurisdictional conflict. Thus, this negates its relevance in international arbitration as a delocalized system that owes no obedience to the *lex fori*.

In the absence of a readily identifiable formula, the international arbitration community avails itself of the New York Convention to determine if sanction-related disputes are arbitrable. However, the New York Convention blurs the line of distinction between the notion of arbitrability and public policy. Article V(2)(a) of the New York Convention provides a cursory reference to the notion of arbitrability without further conceptual clarification. As a result, different international authorities and national arbitration laws delineate inarbitrability on the basis of public policy considerations.

Despite the overlapping features of these two concepts, they produce diverging results as they remain separate spheres. For example, the case of *Fincantier-Cantieri Navali* provides a prime example where the tribunal clarified the distinction between arbitrability and public policy. The tribunal emphasized that: "The fact that the said claim affects public policy would not suffice, in itself, to rule out the arbitrability of the dispute […] arbitrability cannot be denied for the only reason that mandatory provisions of law or given material public policy make the claim null and void."

In addition, some national courts have taken the position that arbitrators have the power to examine and apply provisions of public policy. For instance, in *Ganz v. SNCFT,* the court held that "in international arbitration […] an arbitrator is entitled to apply the principle of public policy". Interestingly, with respect to the concepts of inarbitrability versus public policy exceptions, the U.S. has often narrowly construed the latter. For example, in the *Pemex* decision the Second Circuit Court of Appeals noted the "high hurdle of the public policy exception" finding that "retroactive legislation that cancels existing contract rights is repugnant to United States law." In effect, the implementation of additional or secondary sanctions may qualify as a "retroactive" legislative foreign policy practice that would ultimately be found to be repugnant to U.S. law. Thus, as is observed by the referenced case law, despite the lack of conceptual clarity regarding arbitrability, this concept embodies a wide conceptual dimension and is most amenable to the evolutionary development as the underpinning of arbitration is evolving and becoming more equivalent to a transnational system of justice. That is why distinguished scholars like Emmanuel Gaillard have strongly advocated that international arbitration is to be guided by the rules of the so-called transnational (truly international) public policy, not by national overriding mandatory provisions of individual countries. This sentiment is also in line with the existing paradigm in international arbitration where there is a more international and even transnational approach

towards the application of public policy. This is particularly important in the context of secondary sanctions regime as a foreign policy tools which have international character and requires international law scrutiny.

The Aptness of International Arbitration in Addressing Sanction Related Disputes

Arbitrators are sometimes thought of as foxes guarding the chicken coop, with a bias in favor of business, and as such are allegedly not suited for settling disputes concerning issues of public and international legal importance. It has been contended that as private adjudicators, that arbitrators only serve parties' interests. The argument continues that arbitration therefore cannot account for global interests or internationally well-recognized principles. Furthermore, as a consent-driven mechanism that derives its power from the authority mandated by the parties, the arbitrator's task is to effectuate the intent of the parties, rather than to enforce the statute or comply with internationally recognized norms. It has been argued that international arbitration cannot address issues like secondary sanctions that have international weight and may warrant international public law scrutiny.

However, these arguments are unwarranted. Whilst arbitrators are privately appointed, that does not make them unable to assess issues with public law elements. In fact, in the context of mandatory rules, Professor Berman observed that despite arbitrators being privately appointed, an arbitral tribunal has a public role and function to perform and cannot remain categorically deaf to the values enshrined in principles such as the rule of law. Arbitrators cannot be deprived of the authority to take international rules and principles into account. For instance, in *Philips Petroleum Co v. Iran*, the tribunal resorted to well-established principles and remedies under public international law to ascertain whether intangible property rights like contract rights are capable of protection *per se*. The tribunal noted that: "expropriation by or attributable to a State of the property of an alien gives rise under international law to liability for compensation [..] such as the contract rights involved in the present case."

Therefore, arbitrators, in examining the scope of a sanction's application, have been entrusted with a considerable degree of freedom to assess their *legality*. They are entitled to assess the validity of secondary sanctions through the prism of public international law. In this respect, if the conduct of the *sanctioned* state, or party does not amount to a breach of international norms or international public policy, then the issue remains ripe for international arbitration. Similarly, if a secondary sanction is evidently based on discriminatory motives by a domestic or international adjudicator, then international arbitration has the discretion to assert that there has been an exercise of *indirect extraterritorial jurisdiction* that is incompatible with the traditionally recognized basis of jurisdiction in public international law.

Furthermore, Dr. Cortese observes that "the appreciation of a situation in which international economic sanctions are adopted involves a complex assessment of the state of international law." Similarly, Dr. Azeredo de Silveria also recognizes that economic sanctions are subject to the limits that international law imposes with regard to its applicability and legitimacy. Thus, this blog post proposes that arbitration is a well-suited mechanism to adjudicate sanction-related disputes. This is because it examines the public international character of sanctions by scrutinizing the effect and legal nature of secondary sanctions through an international law lens.

The argument that the private nature of arbitration renders it amenable to decide in favor of private interests has not been borne out in practice. Many scholars have affirmed that the principal obligation of an arbitrator to render an accurate award that is loyal to the context of the relevant disputes. Furthermore, the tribunal in *Ministry of Defense of Iran v. Cubic Defense System*, decided that rendering an award in favor of a sanctioned party does not violate the fundamental public policy behind the sanction. In this case, the arbitrators declared the sanction unlawful by using their discretion and inquiring in its effect and purposes.

Ultimately, arbitration may be better-suited to examine sanction related disputes than domestic courts. This is mainly due to the fact that a conflict of law analysis predominately employs the concept of comity to ascertain the scope and applicability of unilateral sanctions. Comity is a non-legal binding norm predicated on notions like reciprocity, expectation of courtesy and morality, which may render a court's decision more arbitrary. International commercial arbitration and its reciprocity in employing international law principles, may render the final outcome more predictable and consistent.

Concluding Remarks

The modern incarnation of arbitration as a system of transnational justice enables today's legal system to resolve secondary sanctions. International arbitration is well-equipped to strike a balance between a desire of efficiency in international commerce and the need for the enforcement of public policy issues and sanction-related disputes. As the current paradigm reveals, this adjudicative system embodies a detailed and heightened standard of review. Entrusting arbitrators to handle sanction-related disputes will usher arbitration into a new era, as a viable, potent system of international dispute resolution.

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