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Asset Freezes and the Payment of Advances on Costs: Are the Proceedings Bound to End Before They Have Even Begun?

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This post is the first in a series of three regarding the potential impact of economic sanctions on arbitral and financial institutions. The series addresses critical issues faced by such institutions as a result of restrictions on transfers of funds under primary and secondary sanctions programmes. This first entry discusses the potential effects of asset freezes. Subsequent entries will focus on US secondary sanctions against Iran and against Russia.

While some sanctions programmes make certain types of claims inadmissible and/or prohibit the satisfaction of claims arising out of contracts affected by these programmes, economic sanctions do not, as a matter of principle, prohibit the submission to arbitration of disputes involving one or more targeted parties. Over the last few years, representatives of many major arbitral institutions have readily made public statements to this effect.[1)]

That said, arbitral institutions and banks that maintain accounts in which advances on costs are deposited are subject to the sanctions laws and regulations of their respective jurisdictions.[2)] To determine the obligations of arbitral and financial institutions, the specific terms of each sanctions programme must therefore be examined on a case-by-case basis, and arbitral and financial institutions must have in place screening processes that allow them to identify whether any of the parties to an arbitration is (or is owned or controlled by) a person or entity specifically targeted by a sanctions programme (a “Designated Person”).

Payment of a Registration Fee or of an Advance on Costs

Typically, asset freezes are two-pronged: they prescribe the blocking of assets and economic resources owned or controlled by Designated Persons, hence prohibit, in particular, any action that would allow the management or use of such assets; in addition, they prohibit making assets or economic resources available to or for the benefit of Designated Persons. Some programmes also provide that persons and institutions that hold or manage funds or have knowledge of economic resources which ought to be deemed to fall within the ambit of an asset freeze, have a reporting obligation.

It goes without saying that if a party to an arbitration is (or is owned or controlled by) a Designated Person whose assets are frozen, none of its assets in the sanctioning state may be transferred. Furthermore, even if an order to transfer funds is effectively processed (for instance, by a bank in the country against which sanctions are in place), these funds must be frozen by any recipient bank

in the sanctioning state, and the competent authorities might have to be informed of the existence of frozen funds. Similarly, if a party becomes a Designated Person in the course of an arbitration, advances on costs already transferred to the account of an arbitral institution (and of which the party in question usually remains the owner or beneficial owner) must in principle be immediately frozen and the existence of frozen assets might have to be reported to the competent authorities.

In sum, "*the arbitral tribunal, or institution, shall, as would any entity falling under the scope of the sanctions, report to the competent authorities any transfer of funds from a blacklisted individual or party domiciled in a sanctioned country* [should transfers from and to a party domiciled in a sanctioned country be prohibited]. *Similarly, the bank that receives the advance on costs shall freeze the portion of the advance it received from* [a] *blacklisted individual or entity, irrespective of whether the advance was paid before or after the entry into force of the sanction*."[3)]

This being said, under many sanctions programmes, payments from blocked accounts and transfers of frozen assets may exceptionally be authorised.

Certain EU sanctions programmes contain explicit carve-out provisions for the payment of legal services, allowing Member States to release frozen funds if it has been determined that these funds are intended exclusively for payment of reasonable professional fees or reimbursement of incurred expenses associated with the provision of legal services. As to Swiss sanctions, they stipulate that payments from blocked accounts and transfers of frozen assets may exceptionally be authorised *inter alia* if this is necessary in order to avoid hardship or to honour an existing contract. Situations of hardship are considered by certain authors to cover situations in which assets are required for the payment of legal fees, advances on costs, court costs or the like, and in which a party's procedural rights could be irreparably harmed should the required funds not be released.[4)] It has also been convincingly argued that a release of funds for the payment of a registration fee and advances on costs would allow a Designated Person to honour an existing contract, namely an arbitration agreement.[5)]

It may thus be possible to obtain, on a case-by-case basis, a specific authorisation (or specific license) for the payment of registration fees and advances on costs. Note, in this respect, that it has been suggested that both the party subject to sanctions and the arbitral institution might need to apply for such an authorisation, in order to access and to receive frozen funds, respectively.[6)]

A licence is in principle required even for payments made by a non-designated third party on behalf of a Designated Person. EU sanctions programmes typically prohibit EU operators from taking part, knowingly and intentionally, in any activity the object or effect of which is to circumvent an EU asset freeze, including transactions conducted at the direction of a Designated Person. In Switzerland, while only some programmes explicitly refer, in addition to assets owned or controlled by Designated Persons, to assets owned or controlled by persons or entities acting on behalf of the latter or upon their instructions, it has been determined by the State Secretariat for Economic Affairs (SECO), the supervisory authority appointed by the Swiss government, that assets of such third parties must in any event be deemed to fall within the definition of assets "controlled" by a Designated Person.[7)]

Caution is therefore advisable: should a party be a Designated Person, funds transferred on its behalf, be it by a third party that is itself neither listed nor owned/controlled by the party in

question, must in principle be frozen unless and until a specific authorisation has been granted, and any reporting obligation must be abided by.

Substitute Payment of an Advance on Costs

If a party does not pay its share of the advance on costs on the ground that its funds are frozen, is the other party entitled, from a sanctions law perspective, to make a substitute payment? Could such a substitute payment for a Designated Person (or for a party owned or controlled by a Designated Person) be regarded as a way of making assets indirectly available to a Designated Person, in breach of prescriptions on asset freezes?

This question has significant practical relevance, in particular if it is the respondent's assets that are frozen, as this party might have no incentive to seek their release for the purpose of paying its share of the advance on cost. Should a substitute payment be considered to fall within the scope of proscribed activities, the proceedings might well be paralysed.

Indeed, while sanctions programmes imposing asset freezes set out mechanisms to authorise, in certain circumstances, transfers of frozen funds, they usually do not afford a non-designated person the right to seek an authorisation to make (non-frozen) assets available to a Designated Person.

The only way out of such a deadlock might therefore be to reach out to the competent authority and seek confirmation that a substitute payment would be lawful. It should of course be made clear that preventing a substitute payment might ultimately serve the interests of the designated party.

Return of an Unused Portion of an Advance on Costs

As noted above, programmes which impose an asset freeze usually prohibit making available to Designated Persons, directly or indirectly, any assets or economic resources.

In light of this, it might be unlawful to transfer back the unused portion of an advance on costs to a Designated Person (or a person or entity owned or controlled by, or acting on behalf or upon the instructions of, a Designated Person), even if such an advance was actually released, by means of a specific authorisation or licence, for purposes of the arbitration proceedings.

The only way of lawfully returning an unused portion of an advance on costs might therefore be to place the amount in a blocked account and, if required, to report all relevant information to the competent authority.

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References

?1 See, for instance, ICC, *News: International Economic Sanctions*, 1 July 2015, accessible at <https://iccwbo.org/media-wall/news-speeches/international-economic-sanctions/>, and the Joint Statement of the ICC, LCIA and SCC entitled "The Potential Impact of the EU Sanctions Against Russia on International Arbitration Administered by EU-Based Institutions" dated 17 June 2015, accessible at <https://sccinstitute.com/media/80988/legal-insight-icc_lcia_scc-on-sanctions_17-june-2015.pdf>.

?2 Interestingly, in 2015, the ICC went so far as to declare itself bound to operate in accordance even with US sanctions – see ICC, *News: International Economic Sanctions*, 1 July 2015, accessible at <https://iccwbo.org/media-wall/news-speeches/international-economic-sanctions/>.

?3 Elliott Geisinger/Philippe Bärtsch/Julie Raneda/Solomon Ebere, The Impact of International Trade Sanctions on Contractual Obligations and on International Commercial Arbitration, International Business Law Journal, 2012(4), pp. 431-432.

?4 Olivier Thormann/Anne-Claude Scheidegger/Nicolas Bottinelli/Robert Zimmermann/Alain Chablais, Séquestre, blocage et sanctions, *in* Giroud/Rordorf-Braun (eds), Droit suisse des sanctions et de la confiscation internationales, 2020, fn. 371.

?5 Mathias Audit, L'effet des sanctions économiques internationales sur l'arbitrage international, *in* Loquin/Manciaux (dir.) L'ordre public et l'arbitrage, Actes du colloque des 15 et 16 mars 2013 (Dijon), 2014, p. 147.

?6 Evgeniya Rubinina/Romina Rivero/Mali Torres/Daniel Mills/Xenia Kalognomas/Carlos Arrebola/Krupa Vekaria, Impact of Sanctions on Arbitration, Practical Law UK Practice Note w-030-4886, 2021, p. 8. See also on this question Mathias Audit, L'effet des sanctions économiques internationales sur l'arbitrage international, *in* Loquin/Manciaux (dir.) L'ordre public et l'arbitrage, Actes du colloque des 15 et 16 mars 2013 (Dijon), 2014, pp. 146-147.

?7 Financial Action Task Force/Groupe d'action financière, 3ème Rapport d'évaluation mutuelle de la lutte anti-blanchiment de capitaux et contre le financement du terrorisme, Suisse, November 2005, p. 58.

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