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Should Arbitral Tribunals Apply Sanctions Against Russia as Overriding Mandatory Rules?

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When and how arbitral tribunals should give effect to international sanctions is a long-standing question in international arbitration. Unilateral economic sanctions have been traditionally characterised as factual impediments that could trigger *force majeure* or frustration of purpose defences. However, a growing number of scholars and practitioners have criticised this factual approach and have advocated for a legal one.[1)]

Under this legal approach, sanctions regimes are regarded as laws that apply to the dispute as part of the governing law of the contract or as overriding mandatory rules, rather than facts that frustrate the contract's performance. The issue here is that unless sanctions are applied as overriding mandatory rules, parties to a dispute can easily circumvent them by making a clever choice of law. Therefore, this approach is hard to apply since the enforcement of foreign mandatory rules in international arbitration is an issue far from settled and limited only to a narrow interpretation of public policy.

The Limits of the *Force Majeure* Approach

If international sanctions are considered as a fact, the party to a dispute has to prove that the relevant sanctions meet the requirements necessary to qualify as a factual impediment. This approach entails two considerations. First, the sanctions' effect must fall within *force majeure* definition under the applicable law. Second, once the *force majeure* threshold is met, it does not matter whether the sanctions intended to have such an effect upon the agreement or the parties.

However, characterising sanctions as *force majeure* events is a difficult task. There is no consistency as to whether sanctions fall within this contractual defence. Even parties to a contract show conflicting approaches in assessing the international sanctions' consequences. For instance, after concluding a supply agreement with a Russian company, Petroecuador declared *force majeure* because the payment was affected by sanctions against Russia. The next day Petroecuador lifted the *force majeure* declaration after reaching a different payment arrangement with the Russian company.

To what extent parties to a contract can rely on a force majeure defence amid international sanctions is unpredictable. How far do sanctions prevent parties from performing a contract? As showcased by the award in *National Oil Corporation v Libyan Sun Oil Company* (ICC Case No. 4462), if the sanctions do not entirely preclude a sanctioned party from performing the contract,

there is no *force majeure* event. Conversely, in an award from the Milan Chamber of National and International Arbitration[2)], the defendant successfully raised a *force majeure* defence due to an embargo against Iraq.

In order to avoid unexpected outcomes, it is more common to find clauses aiming at directly addressing the consequences of international sanctions. Nevertheless, as shown by *Mamancochet Mining Ltd v Aegis Managing Agency Ltd & Ors* and *Lamesa Investments Ltd v Cynergy Bank Ltd*, how these clauses are enforced varies depending on the wording.

A Shift Towards Rules Rather Than Facts

Some recent discussions suggest that the characterisation of international sanctions is shifting from a *force majeure* approach towards a legal one. Under this approach, sanctions can be construed as overriding mandatory rules which means that they could apply to the dispute regardless of the parties' choice of law.

For example, in *Banco San Juan Internacional Inc v Petroleos De Venezuela SA*, PDVSA unsuccessfully argued that US sanctions against Venezuela were applicable as overriding mandatory rules and, therefore, rendered the underlying contract unlawful.

Arguably, the enactment of blocking statutes implies that States are also considering international sanctions as rules. These statutes limit international sanctions' effects within a jurisdiction, render the application of international sanctions ineffective and bar the enforcement of such sanctions in court or arbitration.

If sanctions were an event that automatically triggered a *force majeure* defence, it would be unnecessary to pass a regulation precluding the "acknowledgement" of that event. Blocking statutes emphasise the legal nature of international sanctions and constitute a legal defence against them.

Certainly, the application of overriding mandatory rules in international arbitration is complex. At the outset, it is tricky to claim that arbitral tribunals should disregard a voluntary choice of law and instead apply a different law. This is even more challenging as international arbitration is firmly based on party autonomy. A case from the Stockholm Chamber of Commerce in 2011 offers an example of the application of overriding mandatory rules in international arbitration.[3)]

Therefore, a party can argue that characterising international sanctions as overriding mandatory rules does not lead to a more consistent application of sanctions. If the enforcement of foreign mandatory rules is uncommon and limited only to a narrow interpretation of public policy, how could sanctions ever be applied? Moreover, some arbitral tribunals have insisted that they: "*do not need to apply foreign mandatory rules which merely serve to enforce national economic or political interests, however, close the connection of the case to that country may be*".[4)]

International Sanctions Against Russia as International Public Policy

International sanctions largely depend on the sanctioning States' political interests and foreign policy strategies. Therefore, sanctions can come and go, quickly and quite frequently. Arguably, a policy that changes several times over a couple of years cannot be part of that State's public policy. However, endorsing this approach implies that parties to a contract can circumvent international

sanctions by making a clever choice of law or signing an arbitration agreement rendering sanctions regimes ineffective.

Despite a new wave of coordinated sanctions against Russia, the question of whether they can be considered as part of the international public policy of the sanctioning State is a complex one. One decision of the Ukrainian Supreme Court underscores these obstacles. In 2020, the Ukrainian Supreme Court ruled that sanctions enacted by Ukraine against a Russian party cannot affect the enforcement of an arbitral award on public policy grounds.

Admittedly, the circumstances in 2022 are quite different from those in 2020. There is now an unprecedented international consensus in adopting sweeping and comprehensive sanctions against Russia for Ukraine's invasion. Since Russia can block any decision in the Security Council, States are coordinating unilateral sanctions daily. Even private companies are leaving Russia as a protest. Could these new sanctions be considered international public policy and, therefore, be compelling enough to be applied as overriding mandatory rules?

A decision of the Paris Court of Appeal in 2020 offers some guidance. In this case, one party applied to set aside the award because it failed to take into account US sanctions imposed against Iran. The court ruled that unilateral sanctions cannot be regarded as a manifestation of an international consensus. Furthermore, both France and the EU disputed the lawfulness of those US sanctions. Consequently, they were not part of French international public policy.

One door is left open, though. As stated by the Paris Court of Appeal, international public policy seeks to preserve certain fundamental values. Some international consensus is also relevant in this assessment. The fact that western countries are coherently enacting sanctions against Russia suggests that this consensus has been reached. Even States once reluctant are seeking to keep up with the international community. One could even argue that these sanctions are trying to condemn a violation of the fundamental values of liberal democracies.

From this perspective, arbitral tribunals should not ignore the consensus reached by several States imposing sanctions as a consequence of the invasion of Ukraine by Russia. An award failing to take sanctions into account could end up being unenforceable. Disputes arising out of the sanctions against Russia will test courts and arbitrators again. This might be an opportunity to encourage arbitrators to adopt the legal approach when assessing international sanctions' enforcement.

References

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?3 SCC Case No. 158/2011, Yearbook Commercial Arbitration – Volume XXXVIII.

?4 Case 15972, ICC Dispute Resolution Bulletin 2016 No. 1.

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