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Sanctions in Current Geopolitical Climate: Challenges to International Arbitration in the Context of the Russia-Ukraine War

Stephanie Tsang · Thursday, April 4th, 2024

In a world where present geopolitical tensions continue to worsen and the current global order continues to show signs of [disintegration](#), sanctions have emerged as a key strategic tool to [pressure](#) third countries to comply with their international law obligations and [further prevent](#) additional violations of international agreements. With this comes disputes in a myriad of areas that international arbitration can help resolve. Simultaneously, sanctions pose unique challenges to the administration and operations of international arbitration – this post will focus on two of these negative implications. Understanding the potential ramifications that sanctions pose to international arbitration can ensure that these measures' impacts on the dispute settlement mechanism can be adequately addressed and, to the extent they are harmful, minimized. This thus allows for increased efficiency in arbitral proceedings administration and the dispute resolution process, and the achievement of a greater balance between the right of countries to impose sanctions and the sanctioned parties' rights in international arbitration.

Difficulties Faced by Sanctioned Parties in Raising Disputes

For sanctioned parties, failure to comply with sanctions regimes can result in [potential criminal prosecution](#), [imprisonment](#), and [substantial monetary fines](#). These prospects may make commencing arbitral disputes in the future harder or more undesirable.

Difficulty in Receiving Legal Services and Initiating International Arbitrations

Aside from travel bans making sanctioned persons' travels to arbitration venues harder, countries, such as [the US](#), have imposed financial sanctions, including restricting the receipt of payment for the provision of legal services from sanctioned persons. Particularly, unless [licenses](#) have been granted, arbitral institutions are prohibited from receiving sanctioned persons' monies, while multiple Russian banks have also been expelled from the SWIFT banking system since March 2022. Thus, sanctioned persons with frozen assets and Russian bank accounts will find it difficult to make the necessary payments to even initiate arbitral proceedings.

Barring any exemptions in the sanction regimes, arbitrators and arbitral organizations can [face repercussions](#) for engaging in an arbitral dispute involving a sanctioned entity. Since October 2022,

the EU has [prohibited](#) the provision of legal advisory services to the Russian government and any legal entities formed in the country. Hence, Russian disputing parties may be unable to retain legal representation, thereby potentially hindering them from bringing an arbitral claim, as well as raising questions on procedural fairness and access to justice. Complying with such principles is crucial in maintaining international arbitration's integrity, legitimacy, and credibility and protecting the good administration of arbitral justice. Adherence to these principles becomes all the more important in the context of [growing mistrust and disillusion](#) in the *status quo*, where heightened criticisms of international arbitration that threaten to undermine the mechanism's effectiveness may occur.

In the US, specific licenses for legal representation are granted on a case-by-case basis, thus obtaining such authorizations is not guaranteed. In contrast, the UK has granted general licenses, permitting the sanctioned person to [receive legal representation](#) in the country, and allowing the London Court of International Arbitration to [receive legal fees](#) from sanctioned persons. Such licenses are however subject to pecuniary limits on the total amount of permissible legal fees and expenses; they are also often only valid for [six months](#) at a time, with the possibility of modifications, cancellations, and repeals occurring whenever. Thus, these time-limited licenses create uncertainty for Russian parties in disputes as to whether they can retain their current counsel in the UK or must find alternate counsel, for example, in Russia or elsewhere. All of these, therefore, continue to inhibit sanctioned persons' ability to retain legal representation, resulting in more reluctance to initiate arbitral disputes.

Jurisdictional Difficulties

To avoid the aforementioned problems, disputing parties may gravitate towards launching an arbitral dispute in a sanctions-neutral country. However, this is easier said than done, as domestic courts can refuse to discontinue litigation over international arbitral proceedings. Such was the case in *JSC Uraltransmash v. PESA*, where the Russian Supreme Court held that Russian courts had [exclusive jurisdiction](#) over disputes involving sanctioned entities and that anti-suit injunctions, preventing dispute settlement proceedings from commencing overseas, could be filed.

Significantly, in June 2023, the Arbitrazh Court of St. Petersburg refused to suspend litigation proceedings over arbitral proceedings at the Hong Kong International Arbitration Centre (HKIAC). It [observed](#) that the claimant, who was sanctioned by the EU, would not receive a fair trial at the HKIAC due to the UK's historical influences over Hong Kong's legal system and the role British and European judges played in the city's judiciary. This judgment can lead to a dangerous precedent where even arbitral institutions in non-sanctioning countries can be deemed as not sanctions-neutral – leaving sanctioned entities with even fewer venues to commence arbitration, thus further undermining their access to justice.

Notably, in the same dispute, a subsequent judgment from Hong Kong's Court of First Instance (CFI) – in which the defendant was seeking to discharge an anti-suit injunction requiring that Russian proceedings be stayed – reached a different conclusion than the St. Petersburg court. The Hong Kong court [affirmed](#) that the defendant had access to justice and dismissed the defendant's arguments that the arbitration agreement was invalid. The court also rejected the notion that Russian courts had exclusive jurisdiction over the dispute due to the sanctioned party's inability to secure a fair arbitral proceeding in Hong Kong. The court noted as support for its holding the sanctioned person's successful obtention of legal representation in Hong Kong, its appointment of its nominated arbitrator, and the inapplicability of EU sanctions in the city. Against this backdrop,

to the extent that Hong Kong courts continue to generally **confirm** the validity of arbitration agreements if the seat of arbitration is independent, the conflicting conclusions of the Hong Kong and St. Petersburg judgments can create potential problems on jurisdiction for disputing parties. Thus, complications in the arbitral proceedings' initiation can arise, particularly where Russian trade and investment agreements provide for the resolution of disputes via international arbitration.

Enforcement

Obtaining an award is only half the battle, as compliance is not guaranteed, particularly when current geopolitical rivals have **no incentives** to do so. Hence, enforcement proceedings will be useful to compel a losing party that does not respond to the winning party's prompts to comply with an arbitral award. However, the imposition of sanctions can lead to issues in the implementation of enforcement proceedings.

Refusal of Enforcement

With some limited exceptions, such as the **September 2022 landmark judgment** in Ukraine, in which the Supreme Court commented in passing that Ukrainian courts could reject an ICSID award enforcement application on the basis that it had **violated Ukraine's public policy**, domestic courts cannot refuse to enforce an award rendered under the **ICSID Convention**. However, the New York Convention allows courts to refuse enforcement of non-ICSID awards on certain grounds, including the losing party's **inability to present its case** during the initial proceedings.

Concerning sanctions, such grounds can arise, for example, where the sanctioned persons' inability to secure legal representation had affected their capacity to present their case adequately – following Russia's invasion of Ukraine, **numerous law firms** had either disassociated themselves from sanctioned Russian entities, terminated their business relationship with those entities, or dropped out from representing these parties in dispute proceedings. Here, the analysis of a CFI judgment – *CIC v. Wu and Ors*, may be useful. In this case, while the lack of legal representation was not an issue, the court had nevertheless concluded a refusal to enforce the concerned award was warranted. This was because the losing party's due process had been violated, partly because its fair chance to **present its case** had been denied. In this sense, whether a defense that a lack of legal representation had affected a party's ability to present its case will be accepted will depend on several factors, including whether the party representing itself had received procedural fairness.

Execution of Assets

Sanction regimes can contain **carve-outs** for the execution of frozen or blocked assets to satisfy an arbitral award; and courts have also permitted applying **specific enforcement instruments** in instances where assets have been transferred outside of the country. However, many of these tools are inapplicable or are subject to restrictions. For example, **Schedule 5 of the Russia (Sanctions) (EU Exit) Regulations 2019** only **allows** the usage of a frozen asset to satisfy an arbitral award if the award had been rendered before the concerned party was sanctioned, while in the EU, **authorization from national competent authorities** must be obtained, on top of satisfying various conditions. These limitations can thus impede the execution of assets in enforcement proceedings involving sanctioned parties.

Conclusion

It is anticipated that considering the current geopolitical situation, the imposition of sanctions will lead to an influx of arbitral proceedings concerning a wide range of areas of law, such as energy and investment.

The aforesaid issues are only two fragments of a wider problem that sanctions pose to international arbitration proceedings. Adequately addressing and minimizing such broader complications will be important to fully harness the opportunities that are brought forth by sanctions and to maintain confidence in international arbitration as an effective and impartial dispute settlement mechanism. Ensuring the sanctioned parties' access to legal representation and ability to adequately present their case in arbitral proceedings is essential to the protection of their right to access justice and maintaining the rule of law. In this sense, minimizing the risks that sanctions present will require a multifaceted approach, such as facilitating payments from arbitral institutions to sanctioned persons through the usage of [neutral countries' currencies](#), [granting licenses](#) to arbitral institutions, and [relaxing](#) the sanctions carve-out provisions.

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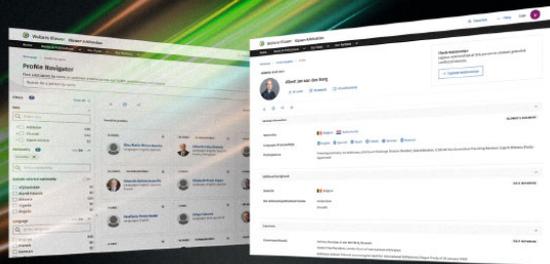
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