

Russian foreign investments at risk: why bring investment disputes relating to Russia to the Hong Kong International Arbitration Centre?

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EDITORIAL

This issue of *Asian Dispute Review* begins with a report by the Hong Kong International Arbitration Centre which provides an insightful analysis on dealing with African-Asian disputes. This is followed by a contribution from Nadja Alexander and Alvin Leu Jun Kang, who take a detailed look at APEC's new ODR Framework. Zhe Chen, Shan Wang and Walter Chen then review the current legal framework of and judicial practice adopted by the courts in relation to the recognition and enforcement of foreign judgments in the People's Republic of China, including recent developments.

Our In-House Counsel Focus article, written by Charles Ho Wang Mak and Roslyn Lai, discusses the practicalities of referring Russia-related investment disputes to the HKIAC. The Jurisdiction Focus article by Adrian Mak and Diana Bayzakova then provides a useful and timely update on arbitration developments in Uzbekistan.

Susan Crennan then gives an illuminating insight into Neil Kaplan and Chiann Bao's newly published book *So, Now You Are an Arbitrator*.

Finally, this issue concludes with the News section written by Robert Morgan.

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Russian Foreign Investments at Risk: Why Bring Investment Disputes Relating to Russia to the Hong Kong International Arbitration Centre?

Charles Ho Wang Mak & Roslyn Lai

This article discusses the proliferation of foreign investors seeking redress through arbitration as a result of the international sanctions imposed against Russia and special retaliatory economic counter-measures imposed against certain investors. It suggests that HKIAC, as a Permanent Arbitration Institution (PAI) designated under Russian law, would be a preferred arbitral institution for the resolution of these disputes and argues that Russian-related disputes administered at HKIAC can achieve practicable results for investors with assets in Russia, highlighting several benefits and challenges accruing to such parties as a result of PAI designation.

Introduction

The imposition of international sanctions on Russia has resulted in the freezing of half of the nation's foreign exchange reserves. In response, Russia has enacted retaliatory special

economic counter-measures against foreign investors affiliated with sanctions-imposing countries. Accordingly, this will lead to an increase in claims involving Russian international investment agreements.

The role of investment arbitration in the investor-State dispute settlement (ISDS) system will grow as a result of the proliferation of international investment claims brought by investors against Russia. As Hong Kong International Arbitration Centre (HKIAC) was designated as a Permanent Arbitration Institution (PAI) under Russian law in April 2019, the authors suggest that it will become the preferred arbitral institution for Russian-related international investment disputes. Following Russia's Arbitration Reform, which came into force in September 2016,¹ the designation 'PAI' attaches to those institutions that have obtained special government authorisation and thus the status to continue operating in Russia. Arbitral institutions that do not obtain PAI status will only be able to render *ad hoc* arbitrations under Russian law.

“The imposition of international sanctions on Russia ... [and that country's] retaliatory special economic counter-measures [enacted] against foreign investors affiliated with sanctions-imposing countries ... will lead to an increase in claims involving Russian international investment agreements.”

The current *status quo* of sanctions against and by Russia

Sanctions against Russia

The European Union (EU)

With regard to the sanctions imposed against Russia in 2022, the EU has, to date, implemented four packages of sanctions:²

(1) full blocking sanctions on a large list of individuals



and entities of the Communist Party of the Russian Federation;

- (2) a prohibition on providing specialised financial messaging services to certain banks;
- (3) a prohibition on investing and co-investing in Russian investment funds; and
- (4) a ban on the export of certain products and trade restrictions, particularly on luxury goods.

The United States

The nature of the economic sanctions imposed by the US is similar to those of the EU and has the same targets.³

Asian jurisdictions

Australia, Japan, South Korea and Taiwan have taken measures to exclude several Russian banks from the global SWIFT payment system.

Russian retaliatory sanctions

In light of the sanctions imposed against it, Russia developed a series of retaliatory counter-measures, identifying a list of “unfriendly states” which includes all of the EU countries and other countries that support those sanctions.⁴ These counter-measures are intended to protect the Russian rouble and include restrictions on (1) currency transfer by residents involved in foreign economic activities who seek to sell 80%

of all foreign currency received from non-residents, and (2) the transfer of currencies abroad. Other measures include prohibitions on the export of foreign currency and on the export and import of certain products and raw materials, and restrictions on debt repayments.

The impact of sanctions on Russian-related foreign investments

For Russian businesses with interests abroad, direct international sanctions against Russia will have a major impact on commercial relationships. This may lead to an increase in disputes as sanctions will drastically shift the economics of existing contracts, or even render performance impossible. For foreign businesses with assets in Russia, retaliatory sanctions create a double-bind situation in which international sanctions imposed on operating entities in Russia will result in a squeeze in cross-border trading. Simultaneously, these foreign businesses may potentially be subject to Russian retaliatory measures because the domestic entity's parent company may be traced back to an "unfriendly state".

“In light of the sanctions imposed against it, Russia developed a series of retaliatory counter-measures, identifying a list of “unfriendly states” which includes all of the EU countries and other countries that support those sanctions.”

In light of this, what categories of Russian-related foreign investments or assets are likely to be affected?

A cursory examination of the list of sanctions imposed so far suggests that domestic and foreign-related businesses

involved in cross-border trade are set to be affected on two fronts. On the financing front, Russian entities would face a squeeze on foreign exchange payments and on export/import supply agreements. This would mean that contractual performance-related disputes underpinning negative cash flow are very likely to arise.

“For Russian businesses with interests abroad, direct international sanctions against Russia will have a major impact on commercial relationships. This may lead to an increase in disputes as sanctions will drastically shift the economics of existing contracts, or even render performance impossible.”

Another likely species of disputes concerns those falling within the ‘conditional arbitration’ category: that is, disputes that are permitted to be administered by a PAI (including HKIAC), including work and service contracts between Russian State-owned enterprises and foreign businesses. As elaborated below, this is something worth bearing in mind when considering ‘why HKIAC?’

The authors also note three issues that will be affected by disputes arising out of international sanctions imposed by and on Russia.

(1) Practical difficulties for international parties in arbitrating disputes involving economic sanctions

There are general issues relevant to the effective running of arbitration proceedings. These include, for example, whether a designated or appointed arbitrator holding citizenship in “unfriendly states” may decline to act in disputes

involving sanctioned parties or issues relating to sanctions. Alternatively, there may be concerns about an arbitrator's impartiality or independence that could later constitute a valid ground for challenging his or her appointment under a number of institutional rules. There is also the matter of the elevated risk posed to the award or order issued by an arbitral tribunal that is in violation of the arbitrator's own national law.

(2) The impact on parties of the June 2020 anti-sanctions reform of the Russian Commercial Procedure Code

Article 248 of the Russian Commercial Procedure Code (effective as of June 2020) extends the exclusive jurisdiction of Russian courts over disputes with either Russian-sanctioned entities or non-Russian entities under Russian-related sanctions. This entitles a sanctioned Russian party to opt unilaterally for litigation in the Russian courts should its right of access to justice in a foreign court or arbitral forum be restricted.

“For foreign businesses with assets in Russia, retaliatory sanctions create a double-bind situation in which international sanctions imposed on operating entities in Russia will result in a squeeze in cross-border trading.”

Additional risks arise of a sanctioned Russian party proceeding with an anti-suit or anti-arbitration injunction in the Russian courts to prevent a dispute from proceeding in its original forum even if the parties have stipulated the place of arbitration or jurisdiction in their governing law clause. As Hong Kong has not adopted any Russia-related sanctions, any international disputes seated in Russia and administered

at HKIAC would not prejudice a Russian-sanctioned party or limit its access to justice, thereby reducing the risk of unenforceability in a resulting foreign award.

“... [G]eneral issues relevant to the effective running of arbitration proceedings ... include, for example, whether a designated or appointed arbitrator holding citizenship in “unfriendly states” may decline to act in disputes involving sanctioned parties or issues relating to sanctions ... [and] concerns about an arbitrator's impartiality or independence that could later constitute a valid ground for challenging his or her appointment.”

(3) The impact of sanctions on the enforcement of an award where a Russian party is subject to sanctions or where a dispute arose out of the sanctions

It is important to note that there are dual concerns when considering the impact of sanctions on the enforcement of arbitral awards. From the award debtor's perspective, that party may be precluded from making any payments to sanctioned award creditors. From the sanctioned debtor's perspective, that party's debts may be precluded from being paid with frozen funds. Competing considerations of national and international public policy will play a role. In addition, difficulties will arise in practice when trying to enforce awards against targeted Russian entities, as it is probable that enforcement against frozen funds may be impossible.



Why HKIAC?

HKIAC is one of the world's foremost dispute resolution organisations, specialising in arbitration, mediation, adjudication and the adjudication of domain name disputes. HKIAC also provides cutting-edge hearing facilities, which have been named first in the world for location, value for money, IT services and staff friendliness. According to the Queen Mary University of London and White & Case 2021 *International Arbitration Survey: Adapting arbitration to a changing world*,⁵ HKIAC is the third most chosen and used arbitral institution globally. Along with having obtained the 2014 innovation award from Global Arbitration Review (GAR),⁶ HKIAC is at the forefront of creative arbitration practice.⁷

On 4 April 2019, HKIAC announced that the Russian Council for the Development of Arbitration had recommended that it be granted permission to function as a Permanent Arbitral Institution in accordance with art 44(3) of Federal Law No 382-FZ dated 29 December 2015 on Arbitration in the Russian Federation (the Federal Law), as amended by (*inter alia*), Federal Law No 531 dated 27 December 2018. Consequently, the Russian Federation Ministry of Justice granted HKIAC this permission on 25 April 2019.⁸

In accordance with the September 2016 Russian Arbitration Reform, only a PAI as defined by the Federal Law may hear

institutional arbitrations seated in Russia and arbitrations involving specific types of corporate dispute involving Russian enterprises.

According to HKIAC, "as a permanent arbitral institution, HKIAC will become the first international arbitral institution authorized to administer (i) international disputes seated in Russia; (ii) disputes between parties from any special administrative region as defined under Russian law or disputes arising from agreements to carry out activities in any such region; (iii) disputes arising from contracts made in accordance with or in connection with Federal Law No 223-FZ dated 18 July 2011 'On Procurement of Goods, Works and Services by Certain Types of Legal Entities' seated in Russia; and (iv) certain types of corporate disputes in respect of a legal entity in Russia (Article 45(7) and (7.1) of the Federal Law and Article 225.1 of the Russian Arbitral Procedure Code)."⁹

“Article 248 of the Russian Commercial Procedure Code ... extends the exclusive jurisdiction of Russian courts over disputes with either Russian-sanctioned entities or non-Russian entities under Russian-related sanctions. This entitles a sanctioned Russian party to opt unilaterally for litigation in the Russian courts should its right of access to justice in a foreign court or arbitral forum be restricted.”

HKIAC would therefore be the preferred arbitral institution for Russian-related international investment disputes.

Although disputes administered at HKIAC cannot achieve practicable results for investors with assets in Russia, nevertheless, through the New York Convention 1958, arbitration in Hong Kong offers users a binding legal decision that is enforceable in 171 countries worldwide. HKIAC awards are predicted to have a solid record of enforcement in Belt and Road Initiative (BRI) nations and already have an unparalleled history of enforcement in Mainland China.

“Additional risks arise of a sanctioned Russian party proceeding with an anti-suit or anti-arbitration injunction in the Russian courts to prevent a dispute from proceeding in its original forum even if the parties have stipulated the place of arbitration or jurisdiction in their governing law clause.”

Professor Anton Asoskov argued in his article, *The Advantages of Arbitrating Russia-Related Disputes at HKIAC as a Permanent Arbitral Institution under Russian Law* that, given its status as a PAI, choosing HKIAC for arbitrating Russia-related disputes has a number of significant benefits.¹⁰ For example, under Russian law, a party may only request assistance from the Russian courts in the taking of evidence for ongoing arbitral proceedings if the dispute is governed by a PAI and the place of arbitration is in Russia. The Russian Supreme Court has emphasised in Plenary Session that a request for assistance in the taking of evidence may be made in support of arbitrations conducted not only by Russian PAIs but also by non-Russian institutions (such as HKIAC) having PAI status.¹¹ Such a feature demonstrates that HKIAC will be an ideal institution for parties involved in Russian-related disputes.



Under the Federal Law, however, some other corporate disputes, such as derivative claims, may only be adjudicated by institutions having both PAI status and unique procedures for corporate disputes. HKIAC has no such unique procedures for corporate disputes at present. Furthermore, in addition to PAI, a separate division established in Russia is also required for a foreign arbitral institution to manage domestic arbitrations. Thus, in this regard, there are certain limitations for HKIAC.

Yet, Hong Kong and HKIAC remain attractive options for Chinese parties who seek geographical proximity and cultural familiarity and for non-Chinese parties who seek independence, neutrality and international best practice. The Chinese government has also acknowledged and supported Hong Kong's position as a centre for international dispute settlement for the BRI through the implementation of the *Interim Measures Arrangement* between the Hong Kong SAR and Mainland China.¹² By implementing this arrangement, Hong Kong is the first jurisdiction outside of Mainland China in which parties to eligible arbitral proceedings may seek interim relief from Mainland Chinese courts.

Furthermore, the legal framework regulating the mutual recognition and enforcement of arbitral awards between the Hong Kong SAR and Mainland China has also been modified recently. The *Supplemental Arrangement* on this matter, which came into force on 19 May 2021, provides modifications and explanations to the prior enforcement regime of 1999.¹³

Conclusion

Having examined the current *status quo* on the sanctions imposed against Russia and the retaliatory sanctions imposed by Russia, the authors have highlighted that Russian-related disputes in the conditional arbitration category are likely to arise in the future. HKIAC, as a designated PAI, would therefore be a preferred arbitral institution for Russian-related disputes. There are three key advantages to arbitrating Russian-related disputes at HKIAC, as follows.

- (1) As Hong Kong has not adopted any Russian-related sanctions, Russian-seated disputes administered at HKIAC would not prejudice sanctioned parties. This would benefit parties in reducing the risk of unenforceability of a resulting foreign award.
- (2) There are clear advantages to HKIAC’s PAI status with regard to additional judicial support in taking evidence from the Russian courts.
- (3) For Chinese parties with operations in Russia, the geographic proximity of Hong Kong to Greater China and preferential measures in place for cross-border arbitration mean that HKIAC can be an obvious choice for those with vested interests in both regions. ¹³

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“For Chinese parties with operations in Russia, the geographic proximity of Hong Kong to Greater China and preferential measures in place for cross-border arbitration means that HKIAC can be an obvious choice for those with vested interests in both regions.”

1 *Editorial note:* For discussion of the rules on PAI status laid down by Chapter 9 of the Federal Law on Arbitration in the Russian Federation, No 382-FZ of 29 December 2015, see Anton Asoskov, *The Advantages of Arbitrating Russia-Related Disputes at HKIAC as Permanent Arbitral Institution under Russian Law* [2020] Asian DR 75-80.

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9 *Ibid.*

10 Asoskov, *op cit* (note 1 above).

11 *Ibid.*

12 *Arrangement Concerning Mutual Assistance in Court-ordered Interim Measures in Aid of Arbitral Proceedings by the Courts of the Mainland and of the Hong Kong Special Administrative Region* (2020).

13 *Supplemental Arrangement Concerning Mutual Enforcement of Arbitral Awards between the Mainland and the Hong Kong Special Administrative Region* (2019).