

Economic sanctions arbitrability and public policy.

KOTELNIKOV, A.

2020

This is a pre-copyedited, author-produced version of an article accepted for publication in *International Arbitration Law Review* following peer review. The definitive published version KOTELNIKOV, A. 2020. Economic sanctions, arbitrability and public policy. *International arbitration law review*, 23(1), pages 19-39 is available online on Westlaw UK or from Thomson Reuters DocDel service .

ECONOMIC SANCTIONS, ARBITRABILITY AND PUBLIC POLICY

Andrey Kotelnikov*

Abstract

This article, through an overview of international experience, considers the interplay between economic sanctions and international commercial arbitration, in particular, the effect of sanctions on the arbitrability of disputes and the public policy exception. Both arbitrability and public policy have previously been used to address the sanctions issue in arbitration, and the courts will likely have to deal with them again in the future. The article argues that any impact of sanctions on arbitrability of disputes is unjustified, but the use of public policy as a ground to challenge awards and to refuse their recognition and enforcement, as well as to invalidate arbitral agreements, has to remain the primary tool of control for the competent national courts. It also considers how, in the atmosphere of high foreign policy tension, even a court decision to recognise and enforce an arbitral award does not always guarantee the payment of an award debt. Where an overseas government subject to economic sanctions is involved in such a case, this raises a host of additional questions related to sovereign immunity, and may provide other creditors of that state with additional opportunities for the debt recovery.

Keywords: enforcement; setting aside; arbitral awards; sanctions; arbitrability; public policy

1. Introduction

Over the past few decades, economic sanctions became the policy tool of choice for many governments and multinational bodies.

* Andrey Kotelnikov is Lecturer in the Law School, Robert Gordon University (Aberdeen, UK).

Restrictive measures of this kind not only promote the relevant foreign policy objectives, but also influence the functioning of dispute resolution in international commerce, particularly the mechanism of international commercial arbitration, as well as the rights and obligations of parties and arbitral institutions. Such influence may come in many forms. For example, the resolution of a dispute in an arbitral institution may depend on obtaining a licence from the competent authorities so that a party from a sanctions list could legitimately transfer the money to pay an administrative fee. Individuals named on a sanctions list could be unable to enter the territory of a foreign State to testify as witnesses (which, however, would not preclude the tribunal from holding a hearing in another country for this particular purpose). The list of potential procedural hurdles can be fairly long. From a wider perspective, the debates are ongoing in the literature as to whether, and to what extent, the emergence of sanctions regimes influences the popularity of certain arbitral seats on an international scale.¹

One of the most interesting recent examples of sanctions affecting commercial law and dispute resolution involves the relationship between Russia and the majority of Western countries. Following the events in Ukraine and subsequent political developments in 2014-2019, a number of countries – in particular, the United States (US)² and the European Union (EU)³ – adopted restrictive measures targeting economic relations with Russia. Some countries joined the sanctions regime, while the others did not. In

¹ Olga Boltenko, 'Hong Kong Emerges as Russia's Refuge While the EU's Sanctions Cripple Major Russian Businesses' <<http://arbitrationblog.kluwerarbitration.com/2014/11/24/hong-kong-emerges-as-russias-refuge-while-the-eus-sanctions-cripple-major-russian-businesses>> accessed 15 November 2019; Russian Arbitration Association, 'Russian Arbitration Association Survey: The Impact of Sanctions on Commercial Arbitration' (2016) <<http://arbitrations.ru/upload/medialibrary/e1e/2016-raa-survey-on-sanctions-and-arbitration.pdf>> accessed 15 November 2019.

² For the review of the measures in question, see: The US Department of State, 'Ukraine and Russia Sanctions' <<https://www.state.gov/ukraine-and-russia-sanctions>> accessed 15 November 2019.

³ For the review of the measures in question, see: 'EU sanctions against Russia over Ukraine' <<https://www.consilium.europa.eu/en/infographics/eu-sanctions-against-russia-over-ukraine>> accessed 15 November 2019.

turn, the Russian Federation reacted by introducing its own countermeasures targeting the economic relations with the sanctioning states.⁴ As a result, more and more actors in international trade are finding themselves in a position where the continued existence of restrictive measures may influence their rights and obligations arising out of commercial contracts, as well as the resolution of their disputes with trade partners. The interest in sanctions is also growing in Russian legal academia and among the legal profession.⁵ Since the coverage of these developments for the English-speaking readership remains limited, the following discussion will specifically note, where appropriate, the relevant legal position of Russia and Russian law, alongside its international counterparts.

From an arbitrator's perspective deciding whether and to what extent effect should be given to any set of overriding mandatory rules, inconsistent regulation in different countries can present quite a dilemma. International commercial arbitration is a jurisdictional legal process carried out by private individuals, the arbitrators. The arbitral tribunal typically has to take into account the parallel existence of several applicable laws at once. These include the substantive law applicable to commercial relations between the parties, the procedural law that governs the resolution of a dispute in arbitration (*lex arbitri*), the laws of countries where the winning party might seek enforcement of an arbitral award, and other laws with which the dispute has a significant connection.⁶ When these

⁴ See, in particular, the Federal Law of 4 June 2018 No.127-FZ 'On Measures (Countermeasures) against Unfriendly Actions of the United States of America and Other Foreign States'; the Decree of the President of Russian Federation of 6 August 2014 No 560 'On the Application of Certain Special Economic Measures to Ensure the Security of the Russian Federation' (restricting the import into Russia of certain agricultural products originating in the countries that imposed sanctions on Russia); and the Decree of the President of Russian Federation of 22 October 2018 No 592 'On Special Economic Measures in Connection with Ukraine's Unfriendly Actions towards Citizens and Legal Entities of the Russian Federation' (introducing restrictive measures against certain enumerated individuals and legal entities of Ukraine, including the blocking (freezing) of their bank accounts and other property in Russia and a ban on withdrawal of capital from Russia).

⁵ See, e.g., this sizeable collection of articles: *Ekonomicheskie sanktsii protiv Rossii: pravovye vyzovy i perspektivy (Sbornik statei)* / Pod red. S.V. Glandina, M.G. Doraeva. Moscow, 2018.

⁶ On the application of the law other than the law chosen by the parties, see, e.g., Article 11(5) of the Hague Principles on the Choice of Law in International Commercial Contracts (approved 19 March 2015).

competing legal systems take the opposite views on the validity and legitimacy of a certain commercial transaction, the tribunal's task becomes particularly complex. One should also bear in mind that resolution of disputes in international arbitration by definition has an international (or transnational) character, and arbiters are not bound by the provisions of national law to the same extent as judges.⁷

The classic debate between the jurisdictional (procedural) and autonomous theories of arbitration⁸ becomes very pertinent where the arbitrators have to make a choice between application and non-application of national mandatory rules, particularly the rules closely intertwined with international politics. From the vantage point of the autonomous theory and the delocalisation theory,⁹ it is logical to insist that such national regulations must not be directly binding for the tribunal, even where the seat of arbitration is in a country that adopts and enforces economic sanctions. Arbitrators should be free to deviate from such rules if, as a matter of law or legal policy, there is a good reason to do so. It had been pointed out that the state of the seat of the arbitration is not the same as a forum for a domestic court.¹⁰ The seat is merely a state whose procedural law governs the conduct of arbitral proceedings. An arbitral tribunal owes no allegiance to the state of its seat and is not under any legal obligation to uphold its laws and policies.¹¹

Other authors insist that merely because the parties selected arbitration as a method of dispute resolution, it does not mean that they can thereby escape the application of any mandatory rules in a

⁷ See R Y Jennings, 'The Judiciary, International and National, and the Development of International Law' (1996) 45 Int'l & Comp LQ 1, 4.

⁸ See. L.A. Lunts, N.I. Marysheva, *Kurs mezhdunarodnogo chastnogo prava: Tom 3* (Moscow, 1976) 218 - 219; *Arbitrazhnyi protsess: uchebnyk / V.V. Yarkov, ed.* (4th ed., Moscow, 2010) 615; A.G. Kotelnikov, *Pravovaya priroda arbitrazhnogo soglasheniya i posledstviya ego zaklyucheniya*. Dis. ... kand. jurid. nauk (PhD thesis, The Urals State Law Academy, Ekaterinburg 2008) 56, 79.

⁹ Hong-Lin Yu, 'A theoretical overview of the foundations of international commercial Arbitration', 1 *Contemp. Asia Arb. J.* (2008) 255; Kotelnikov (n 8) 62-63.

¹⁰ Mercédeh Azeredo da Silveira, *Trade Sanctions and International Sales* (Kluwer 2014), 98.

¹¹ Pierre Mayer, 'Mandatory Rules of Law In International Arbitration', *Arbitration International*, 2(4) (1986) 274, 277.

national system of law which they do not like. Choosing the applicable law, the parties choose it in its entirety, and if some rules within this system of law cannot be derogated from, they will still apply to the parties' relationship.¹² The success of international arbitration stems, to a large extent, from the support of national governments, and if arbitration were to be seen as a means of evading legitimate regulation and policies, its reputation would suffer.¹³ In addition, arbitrators and administrative personnel of arbitral institutions are merely private individuals who in that capacity must comply with all the laws of the State of their residence. It would be imprudent to ignore this 'personal' dimension because the legislation on sanctions often imposes significant administrative and criminal penalties for non-compliance.

It is submitted that these and other considerations resulting from application or non-application of sanctions regulations in any given dispute, important and complex in their own right, derive to a large extent from the possibility that a non-compliant award might be set aside, or its enforcement might be ultimately refused, by the competent national courts. But how often and in what circumstances have the national courts done so? Among the limited grounds for court intervention provided in the New York Convention 1958, the UNCITRAL Model Law on International Commercial Arbitration and various national statutes, two grounds stand out most prominently: arbitrability and public policy.

Relying on the analysis of recent cases and developments, this article will consider, therefore, the effect of sanctions on the arbitrability of disputes and the public policy exception. It will address the following issues in turn:

¹² A Philip, *Mandatory Rules Public Law (Political Rules) and Choice of Law in the EEC Convention on the Law Applicable to Contractual Obligation* (Holland Publishing House, 1982) 93.

¹³ O Lando, 'The Law Applicable to the Merits of the Dispute', *Arbitration International*, 2(2) (1986) 104, 158.

- 1) The essence and types of economic sanctions, and the significance of various classifications for their effect on international commercial arbitration.
- 2) The effect of sanctions on setting aside and enforcement of arbitral awards, particularly in the context of objective arbitrability and the treatment of sanctions as an element of public policy.

2. Definition and diversity of economic sanctions

In essence, economic sanctions, despite their effect on the private law sphere and the relations between private individuals and companies, are an instrument of foreign policy and an issue of the public international law. Their types are numerous. The most radical measure in the existing 'arsenal' is embargo, i.e. the prohibition of trade with certain States. The embargo may be total, that is, extend to any export-import transactions with the target country, or partial/sectoral when the restriction relates to certain goods or their categories, such as goods that serve military purposes and the dual-purpose goods, i.e. the ones that have both military and civil uses. The boycott is a ban on imports of any goods or services from the target State. Like the embargo, the boycott may be total or partial. Still milder measures include, in particular, making certain commercial or financial transactions subject to prior permission or reporting; and the arrest (freezing) of assets held by the named persons on the territory of the host State. Selective restrictions may relate to economic transactions with certain named individuals or entities.¹⁴

Sanctions usually reflect the political desire to induce a foreign State to perform, or to stop performing, some action or actions. Their specific objectives can be diverse: from forcing a State to cease some

¹⁴ E Geisinger and others, 'The Impact of International Trade Sanctions on Contractual Obligations and on International Commercial Arbitration' [2012] 4 International Business Law Journal 405, 406.

specific human rights violations on its territory to overthrowing of a political regime. The latter appears to be the most common motive. According to one study, in about every third case (80 out of 204 instances examined by the authors), the sanctions' goal was to change the political regime in the target country.¹⁵

It is common to explain economic sanctions as an intermediate measure between words and military action¹⁶ which is particularly useful when verbal condemnation is incapable of producing the desired effect, but the use of military force is impossible or inadequate. The mechanism of most categories of economic sanctions is indirect: their primary object, as a rule, is not the elite who take key decisions in the target State. Instead, the target is the members of the armed forces, the middle class, the workers of the agricultural sector, or the country's population in general.¹⁷ As the UN Secretary-General Kofi Annan noted in his report, 'when robust and comprehensive economic sanctions are directed against authoritarian regimes, a different problem is encountered. Then it is usually the people who suffer, not the political elites whose behaviour triggered the sanctions in the first place. Indeed, those in power, perversely, often benefit from such sanctions by their ability to control and profit from the black market activity and by exploiting them as a pretext for eliminating domestic sources of political opposition.'¹⁸ There is no doubt that economic sanctions could lead to adverse social consequences in the State against which they are directed, including a devastating impact on public health, social care and other vital institutions.¹⁹

¹⁵ GC Hufbauer and others, *Economic Sanctions Reconsidered* (3rd ed. Peterson Institute 2007) 67.

¹⁶ Jonathan Marcus, 'Do Economic Sanctions Work?' (BBC, 26 July 2010) <<http://www.bbc.co.uk/news/world-middle-east-10742109>> accessed 15 November 2019.

¹⁷ J Kirshner, 'The Microfoundations of Economic Sanctions' (1997) 6(3) *Security Studies* 32, 46.

¹⁸ 'We the Peoples: The Role of the United Nations in the twenty-first century. Report of the Secretary-General', A/54/2000, 27 March 2000 <<http://www.un.org/ru/documents/ods.asp?m=A/54/2000>> accessed 15 November 2019, para 231.

¹⁹ SH Allen, DJ Lektzian, 'Economic Sanctions: A Blunt Instrument?' (2013) 50(1) *Journal of Peace Research* 121, 121-135.

Although there is recorded history of the use of economic sanctions (especially unilateral sanctions) against other countries since ancient times, their popularity peaked in the 20th century. According to one empirical study, from 1945 to 2005 there were 1412 cases of their use, or threats of use, in the world, with the greatest number recorded in 1990-2000.²⁰ At the end of the 20th century, the so-called comprehensive sanctions were most popular, well-known examples of which included the UN total embargo against Iraq, Kuwait and Libya. In the subsequent period, when their destructive nature and the extent of damage they caused to the economy and social well-being of the population became better understood, preference shifted to more narrowly targeted sanctions, with their effect limited to designated persons or sectors of the economy.²¹

The latest generation of economic sanctions has also been termed 'smart sanctions',²² which generally includes targeted financial sanctions, arms embargoes, travel bans, and diplomatic restrictions.²³ With such instruments, it becomes increasingly important to consider the exact wording of the regulations in every particular case; one cannot assume that the legal position will be the same as in any given other situation. This invites a particularly careful approach when comparison has to be drawn within the body of case law relying on broadly similar but differently worded sanctions regulations. As the international community accumulates the

²⁰ TC Morgan, N Bapat, Y Kobayashi, 'Threat and Imposition of Economic Sanctions 1945-2005: Updating the TIES Dataset' [2014] Conflict Management and Peace Science 2.

²¹ 'Follow-up to the Millennium Summit. The report of the UN Secretary General', A 59/565, 2 December 2004 (English version) <https://digitallibrary.un.org/record/536113/files/A_59_565-EN.pdf> accessed 15 November 2019, para 79-80.

²² See generally: *Smart Sanctions: Targeting Economic Statecraft* (D Cortright and G A Lopez, eds), Rowman & Littlefield, 2002.

²³ *Ibid*, vii.

experience of drafting sanctions instruments, the respective legal regimes mature, leaving fewer gaps and grey areas.²⁴

One typical provision in the latest generation of sanctions is the rule concerning an authorisation by a competent national body that may allow the applicant to perform an otherwise prohibited transaction. As opposed to a blank prohibition with no exceptions,²⁵ a common way of imposing a restriction has lately been to require an authorisation for a specified transaction or payment, where the prohibition can be implemented by a simple refusal of authorisation.²⁶ The provisions of this nature regularly feature in arbitration and the related court cases. For example, they can make it necessary for an arbitral institution to submit the necessary exemption applications to the relevant authorities, e.g. for the payment of the institution's fees.²⁷ A court may extend the timelines for complying with its order in the proceedings to enforce an arbitral award, where such compliance necessitates a request for authorisation from a competent authority.²⁸ A court (in particular, a US court) may draw a technical distinction between its judgment enforcing an arbitral award in favour of a sanctioned party under the New York Convention 1958 and making the sum in question available to that party, if the competent authority may still grant or refuse the authorisation to transfer the amount in question onwards from that party's frozen bank account.²⁹

²⁴ Sergei Glandin, 'Protsenty vzyskat', *trebovaniya ne udovletvoryat' // Kak sanktsii vliyayut na pravo obratit'sya v mezhdunarodnyi arbitrazh'* (27 August 2019) <https://zakon.ru/blog/2019/08/27/procenty_vzyskat_trebovaniya_ne_udovletvoryat_kak_sankcii_vliyayut_na_pravo_obratitsya_v_mezhdunaro> accessed 15 November 2019.

²⁵ Such blank prohibitions appear in national legislation from time to time, although they are now relatively rare: see, e.g., the restrictions on trade with Eritrea in Section 69b of the German Regulation Implementing the Foreign Trade and Payments Act (Foreign Trade and Payment Regulation – AWV) of 18 December 1986 as amended in 2010.

²⁶ J A Frowein and N Krisch, *Germany*, in: *National Implementation of United Nations Sanctions: A Comparative Study* (V Gowlland-Debbas, D L Tehindrazanarivelo, eds) (Martinus Nijhoff Publishers, 2004) 237.

²⁷ Sections 105-108 of the LCIA Notes for Parties < <https://www.lcia.org/adr-services/lcia-notes-for-parties.aspx>> accessed 15 November 2019.

²⁸ *A v B* [2019] 8 WLUK 82 (Queen's Bench Division, Commercial Court, 15 August 2019).

²⁹ *Ministry of Def. & Support for the Armed Forces of the Islamic Republic of Iran v. Cubic Def. Sys., Inc.*, 665 F3d 1091 (9th Cir 2011). See below the text accompanying note 88 and the subsequent discussion.

The authors who analyse the position of arbitrators in their choice whether to apply a particular national (unilateral or multilateral) sanctions regime adopt a helpful framework calling for the determination, first and foremost, of the relationship between the law of the sanctioning state and the dispute at hand.³⁰ Indeed, the tribunal must take into account a different set of circumstances where the sanctions are imposed by the state whose substantive law governs the dispute (with a further finer distinction as to whether the tribunal has to make the choice for the parties, or whether the contract contains the parties' unequivocal choice)³¹; by the state where arbitration is seated; or the third state with which the dispute has a sufficiently close connection.³² To an extent, this theoretical distinction is helpful also in the present context, and worth bearing in mind when looking at the decisions of national courts analysing arbitrability and public policy in relation to sanctions.

Further, it is important to distinguish between sanctions imposed by the UN Security Council decisions and all other types of economic sanctions. According to Art. 41 of the UN Charter, the Security Council is vested with the power to adopt the relevant measures. Article 25 of the Charter states that the members of the United Nations agree to accept the decisions of the Security Council and to carry them out. Therefore, the implementation of Security Council decisions is an international legal obligation for every UN Member State.

In comparison with these UN sanctions, the use of restrictive economic measures by States unilaterally, as well as their use by members of an international organisation against third States,

³⁰ See da Silveira (n 10), 106-126; T Szabados, 'EU Economic Sanctions in Arbitration', 35 *Journal of International Arbitration* 4 (2018) 439.

³¹ See, in particular, the proposal for taking into account the timing of the imposition of sanctions by da Silveira (n 10) at 111.

³² An example of such a close connection can be found in the ICC Award No 1859 (1973), where the tribunal took into account the Lebanese import restrictions in a dispute arising from a contract between a Japanese seller and a Lebanese importer governed by 'the general principles and usages of international trade'. See also Yves Derains, 'Le statut des usages du commerce international devant les juridictions arbitrales' (1973) 3 *Rev Arb* 1221.

produces no legally binding obligation for the target State. In the Final Report of the International Law Association (New Delhi, 2002), the regime of sanctions under the UN Charter is on the list of international obligations the violation of which can amount to a violation of public policy under Article V of the New York Convention.³³ The report does not mention any other similar measures – perhaps because their status under the New York Convention is a more controversial issue.

The attempts of a State targeted by UN sanctions to neutralise their effect through their domestic law seemed, so far, to be very controversial. For example, the 1990 Iraqi law ‘On the protection of property rights and interests of Iraq in the country and abroad’ stipulated that foreign companies and individuals who fail to comply with their contractual obligations because of the UN sanctions must pay appropriate compensation. Although the domestic courts of Iraq would enforce this rule, in international commercial arbitration the tribunals would probably refuse to give it effect, as this would be obviously inconsistent with the international public order.³⁴

With economic sanctions adopted in the framework of a regional international organisation, or by a single State, the identification of subjects legally bound to comply may present some challenges. By their nature sanctions are territorial, that is, their provisions are binding only on natural and legal persons who, for one reason or another, are under the jurisdiction of the State enacting the sanctions. Despite the understandable political desire to improve the effectiveness of sanctions by expanding their reach, such an extension should have its limits. For example, the restrictions imposed by the EU Regulation 833/2014 of 31 July 2014,³⁵ apply

³³ P Mayer and A Sheppard, ‘Final ILA Report on Public Policy as a Bar to Enforcement of International Arbitration Awards’ (2003) 19 (2) *Arbitration International* 256.

³⁴ Hans van Houtte, ‘Trade Sanctions and Arbitration’ (1997) 25 *International Business Law* 166.

³⁵ Council Regulation (EU) No 833/2014 of 31 July 2014 concerning restrictive measures in view of Russia’s actions destabilising the situation in Ukraine.

within the territory of the EU; to any person who is a national of a Member State or incorporated under the law of a Member State; to any legal person in respect of business done within the EU.³⁶ Thus, other persons not listed in the Regulation have no obligation to adhere to the restrictions it imposes.

An example of an unsuccessful attempt to produce economic sanctions with an extraterritorial effect was the Cuban Liberty and Democratic Solidarity (Libertad) Act of 1996 (also known as the Helms-Burton Act), enacted in the US in 1996. The controversial Title III of this Act established a new cause of action in the US federal courts. Namely, the US citizens whose property was confiscated by the previous Cuban government without compensation received the right to lodge a claim against persons engaged in 'unlawful trafficking' of such assets. These 'traffickers' could include companies from the countries that retained trade relations with Cuba – which included, at that time, many countries of Western Europe, the UK, Mexico and Canada. For the trading companies, the probability of acquiring such property in the course of regular commerce was very high, as, in the early 1960s, the regime of Fidel Castro made a significant number of confiscations. In the US, those foreign companies engaged in trade with Cuba could face liability in the amount equal to the value of the respective property, and if they continued their 'unlawful trafficking' – in the amount equal to its triple value plus interest.³⁷

These provisions of the Helms-Burton Act were met with a widespread scepticism in the international community. The EU in the Regulation 2271/96 of 22 November 1996 declared the judicial decision and arbitral awards based on the Helms-Burton Act and similar extraterritorial acts unenforceable in the territory of its

³⁶ Ibid., Article 13.

³⁷ Sec. 302 of the Act; A Lowenfeld, 'Congress and Cuba: The Helms-Burton Act' (1996) 90(3) *The American Journal of International Law* 419-434; V Lowe, 'Helms-Burton and EC Regulation 2271/96' (1997) 56 *The Cambridge Law Journal* 248-250.

Member States. This Regulation has also made it illegal for businesses and individuals to comply with such laws (including through compliance with requests of foreign courts). Further, it established the possibility of 'reverse' recovery, through the courts in the EU Member States, of losses incurred in the US under the provisions of the Helms-Burton Act and similar laws. The United Kingdom has introduced in its territory a criminal liability for violations of the EU Regulation 2271/96.³⁸ In the UN Resolution 68/8 of 29 October 2013, the General Assembly expressed its concern with the UN Member States adopting acts such as the Helms-Burton Act the extraterritorial effects of which affect the sovereignty of other States, the legitimate interests of foreign citizens and organisations, freedom of trade and navigation.³⁹

However, the US did not abandon the idea of extra-territorial sanctions. A similar story has again unfolded in 2018 when the US withdrew from the Joint Comprehensive Plan of Action (the "Iran nuclear deal") and re-imposed sanctions on this country. In response, the EU sought to protect its operators against the extraterritorial reach of the US sanctions by updating the EU's Blocking Statute (Council Regulation No 2271/96).⁴⁰ Thus, the EU companies doing business in and with Iran once again found themselves in a complex legal environment, where the extra-territorial US sanctions imposed on them one line of action, and the EU Blocking Statute required them to do the opposite. Recognising the dilemma, the above Regulation also allows EU operators who consider that non-compliance with a US requirement or prohibition could seriously damage their interests

³⁸ Extraterritorial US Legislation (Sanctions against Cuba, Iran and Libya) (Protection of Trading Interests) Order 1996, SI 1996/3171.

³⁹ 'Necessity of ending the economic, commercial and financial embargo imposed by the United States of America against Cuba', Resolution A/RES/68/8 <<http://www.un.org/en/ga/68/resolutions.shtml>> accessed 15 November 2019.

⁴⁰ 'The Blocking Statute: protecting EU operators, reinforcing European strategic autonomy' <https://ec.europa.eu/fpi/what-we-do/blocking-statute_en> accessed 15 November 2019.

to apply to the Commission for an authorisation to comply with the US sanctions.⁴¹

3. Challenge and enforcement of arbitral awards

State courts' control of international commercial arbitration is limited and carried out strictly within limits of the national law. Art. V of the New York Convention defines the grounds to refuse enforcement of foreign arbitral awards, which are uniform across all Contracting States of the Convention. The grounds for challenging an award at the seat of arbitration, on the opposite, are within the competence of every individual domestic legislature. To date, there is no international treaty governing the grounds for setting aside of arbitral awards in the country of their origin.

At the same time, the UNCITRAL Model Law on International Commercial Arbitration is an example of successful international harmonisation. It served as a model for the national statutory regulation in more than 70 States.⁴² Art. 34 of the Model Law listing the grounds for setting aside an award is identical to Art. V of the New York Convention. In non-Model Law countries, the list of grounds for challenging an award may differ. However, even in such jurisdictions (which include, among others, England and Scotland), the main ideas behind these grounds if not their wording has significant similarities to those established in the New York Convention.

In those countries where the law permits the review of an award on the merits in some form, the court may verify the correctness of the tribunal's approach, e.g. as to the validity or invalidity of a transaction, without resorting to arbitrability or public policy. For example, section 69 of the English Arbitration Act 1996 provides that,

⁴¹ Id.

⁴² 'Status of the UNCITRAL Model Law on International Commercial Arbitration' <https://uncitral.un.org/en/texts/arbitration/modellaw/commercial_arbitration/status> accessed 15 November 2019.

unless the parties agree otherwise, a party to arbitral proceedings may (upon notice to the other parties and the tribunal) appeal to the court on a question of law arising out of an award made in the proceedings. The court will grant the leave to appeal under this section if several conditions are present. First, the determination of the question must substantially affect the rights of one or more of the parties. Second, the question must be one which the tribunal was asked to determine. Third, according to the findings of fact in the award, the decision of the tribunal on the question must be obviously wrong, or it must be of general public importance, and the decision must be at least open to serious doubt. Finally, the court should be satisfied that despite the agreement of the parties to resolve the matter by arbitration, it is just and proper in all the circumstances for the court to determine the question.⁴³ This option is a specific feature of the English Arbitration Act; the UNCITRAL Model Law excludes the possibility to appeal an award on such grounds.

In most countries, courts can consider economic sanctions from the standpoint of their impact on arbitrability of a dispute and their interpretation as matters of public policy, i.e. as grounds for setting aside or refusing recognition and enforcement of an arbitral award. Art. V of the New York Convention and Art. 34 of the UNCITRAL Model Law allow the court to scrutinise both of these grounds on its initiative, without the need for the parties to raise the issue and provide relevant evidence.

3.1. Arbitrability of a dispute

Arbitrability of a dispute defines which categories of dispute may be resolved by arbitration and which belong to the exclusive competence of the courts.⁴⁴ According to Art. V (2) of the New York

⁴³ For more details, see B Harris, R Planterose, J Teck, *The Arbitration Act 1996: A Commentary* (5th ed. 2014) 357-374.

⁴⁴ N Blackaby and others, *Redfern and Hunter on International Arbitration* (6th ed., OUP 2015) 110.

Convention, the recognition and enforcement of an arbitral award may be refused if the competent authority in the country where recognition and enforcement is sought finds that ... the dispute is not capable of settlement by arbitration under the law of that country. Art. 34 of the UNCITRAL Model Law on International Commercial Arbitration contains a similar provision. Some authors distinguish between objective arbitrability (in the meaning indicated above, also known as arbitrability *ratione materiae*), and subjective arbitrability which determines the ability of certain categories of persons to enter into arbitration agreements (arbitrability *ratione personae*).⁴⁵ Such authors treat the impact of economic sanctions on the possibility of the referral of a dispute to arbitration as a separate issue covered by the rules of objective arbitrability.⁴⁶

The argument that the imposition of sanctions entails non-arbitrability of disputes may proceed as follows. The arbitrators, being merely private individuals, have no authority to determine matters of public law. Issues relating to public policy should be resolved only by national or international courts where the decision-making can consider not only the technical wording but also the political and legal motives behind the regulation. Moreover, arbitrators do not 'belong' to any particular national legal order. They must comply solely with the procedural law of the arbitral seat; they might be citizens of other States or stateless persons. The argument is essentially the same as the one used to exclude from the scope of international commercial arbitration the disputes involving mandatory rules of other nature, e.g. antitrust regulation, patents, and legislation on the securities market.⁴⁷

Nevertheless, already in 1999, the prominent French authors called this logic outdated.⁴⁸ Indeed, if the tribunal simply resolves a

⁴⁵ P Fouchard, E Gallard, B Goldman, *On International Commercial Arbitration* (New York, 1999) 313.

⁴⁶ *Ibid* 358-359.

⁴⁷ Blackaby (n 44) 112-116.

⁴⁸ *Ibid* 358.

dispute between parties in a commercial transaction, it is hard to see how the application of legal rules of whatever kind to this private controversy could have an adverse impact on public law and policy. If the remedy against the losing party in arbitration were solely the obligation to pay a sum of money, such a result would be perfectly consistent with the spirit of the arbitration agreement between the parties who from the very beginning agreed to refer their dispute to arbitration. Even if the tribunal employs an interpretation of the rules of public law different to that which the court might adopt, it does not change a lot. By entering into an arbitration agreement, parties accept that the interpretation of substantive law by the tribunal may be different from the approach of a competent court, but it will be final. This interpretation, regardless of its correctness on the merits, cannot be second-guessed by the national court (except under the provisions similar to section 69 of the English Arbitration Act).

The jurisprudence of national courts broadly supports the arbitrability of disputes involving sanctions. In particular, the US courts strongly support this proposition, even in the context of the most stringent sanction regimes, such as the Cuban Assets Control Regulations.⁴⁹ Likewise, the Swiss courts had been the consistent supporters of the same view over the years.⁵⁰ In the famous case *Air France v Libyan Airlines*, the Quebec Court of Appeal has also ruled that the US sanctions against Libya did not affect arbitrability of the dispute.⁵¹

The dominant view among the commentators has also been that the dispute does not become non-arbitrable merely because it requires the tribunal to apply an economic sanction or other

⁴⁹ *Belship Navigation Inc v Sealift Inc*, 1995 US DIST LEXIS 10541, 1996 AMC 209 (US District Court for the Southern District of New York, 1995).

⁵⁰ See, e.g., *G. SA v V. SpA et Tribunal Arbitral*, 28 April 1992, DFT 118 II 193, c. 5 c.a.a, English translation in *Yearbook Commercial Arbitration* 1993 at 143; *X SA & Y SA v Z SA*, 4 P.119/1998, *ASA Bull.* 1999 at 529.

⁵¹ *Air France v. Libyan Airlines*, *Cour d'appel du Québec*, Judgment of 31 Mar. 2003, *Revue de l'arbitrage* 1365 (2003) with a note by Alain Prujiner.

overriding mandatory rules.⁵² It has even been suggested that the issue of arbitrability in this context is no longer a topic for a serious discussion.⁵³

One can think of at least two additional pragmatic arguments that might be used to justify the monopoly of State courts in the interpretation and application of the public rules on economic sanctions. First, the losing party may attempt to recover the sums it lost in arbitration as damages from the State authority that adopted economic sanctions, if they caused the non-performance or improper performance of the contract. However, the arbitral award will not be binding nor will it be *res judicata* for the relevant State authority. Therefore, all factual and legal aspects of the case will have to be reviewed again by a competent court, which is unlikely to uphold a claim if the imposition of sanctions was lawful. If the decision on the adoption of economic sanctions was in some way inconsistent with the law, recovery of damages from a public authority is nothing out of the ordinary. Such a mechanism exists in many countries, for example, under Art. 417 of the Russian Civil Code.

Second, in theory, arbitration tribunal might order the losing party to perform some actions expressly prohibited under the sanctions regulation. However, for the implementation of this award, the winning party will need to obtain an enforcement order from an appropriate court. The judge will then be able to assess whether such a performance would be consistent with the law, and may refuse the enforcement on the grounds of public policy related to the remedy, rather than to the original arbitrability of a dispute between the parties. If the sanctions in question were not the UN Security Council measures, the decision would remain enforceable in third countries

⁵² Jean-Baptiste Racine, 'L'arbitrage commercial international et les mesures d'embargo, À propos de l'arrêt de la Cour d'appel du Québec du 31 mars 2003', 134 JDI 89, 92 and 95– 101 (2004); Marc Blessing, *Impact of the Extraterritorial Application of Mandatory Rules of Law on International Contracts* (Helbing & Lichtenhahn 1999) 58-59.

⁵³ Mathias Audit, 'L'effet des sanctions économiques internationales sur l'arbitrage international', in *L'ordre public et l'arbitrage, Actes du colloque des 15 et 16 mars 2013 (Dijon)* 143 (LexisNexis 2014) at 147.

that chose not to accede to the sanctions regime. Where the losing party would be willing to comply with the award voluntarily, any actions prohibited by the sanctions would still remain illegal in the relevant countries. Again, it is hard to see a convincing argument against the arbitrability of the dispute here.

A similar argument was, however, accepted by Italian courts in *Societe Fincantieri Cantieri*.⁵⁴ In that case, three Italian companies and the Iraqi Ministry of Defense entered into contracts for the supply of warships. The contractual performance became impossible when in 1990 the UN Security Council Resolution established an embargo on shipments to Iraq. The contracts contained an arbitration clause, but the Italian companies filed a lawsuit with the Italian court arguing that because of the imposition of international sanctions on Iraq, the dispute became non-arbitrable. The trial court rejected this argument, but the Genoa Court of Appeal reversed the decision and held that the dispute could not be subject to arbitration according to Art. 806 of the Italian Code of Civil Procedure. This article provides that the parties may refer the disputes arising between them to arbitrators, except those disputes which may not be the subject of a settlement. The Court pointed out that the UN and the EU sanctions no longer allow the parties to dispose of their rights under the contract, and the submission of the dispute to arbitration can lead to a result expressly prohibited by international sanctions. The Court examined the case on the merits and ruled in favour of the Italian plaintiffs. Subsequently, the Court of Appeal in Paris refused to enforce this decision in France and criticised it, holding that the dispute was subject to arbitration, and the Italian court had no jurisdiction to hear it.⁵⁵

⁵⁴ Genoa Court of Appeal (Italy), 7 May 1994.

⁵⁵ *Legal Department du Ministère de la Justice de la République d'Irak v Société Fincantieri Cantieri Navali Italiani, Société Finmeccanica et Société Armamenti E Aerospazio*. 05/05404. (France, 15 June 2006, Cour d'Appel de Paris). For more details, see: Ivan Philippov, Yaroslau Kryvoi, 'Russia's Mistral Deal under International Sanctions Will the Dispute be Arbitrable?' (LexisPSL Arbitration, 3 October 2014).

A related case came before the ICC tribunal in Geneva in 1994. A Syrian citizen put forward a claim against two Italian companies, demanding the payment of an agency fee for the conclusion of contracts for the supply of military equipment to Iraq. The respondents argued that the dispute has become non-arbitrable because of the embargo. The interim award by a sole arbitrator rejected this argument and confirmed the tribunal's jurisdiction to hear the case. The arbitrator pointed out that he did not doubt that the rules of national and international law, the existence of which the respondents indicated, can be regarded as a part of the international public order. However, the application of such rules by an arbitral tribunal and arbitrability of the claim are two different things. The mere fact that the arbitrator will be required to apply those or other public law rules in resolving the case does not mean that the dispute becomes non-arbitrable. An arbitrator is under an obligation to follow the requirements of the international public order but is not required, for this reason alone, to decline jurisdiction.⁵⁶ The respondents challenged the interim award, but the Swiss Federal Tribunal agreed with the views of the sole arbitrator.⁵⁷ Thus, even within this controversial line of cases, the majority of courts supported the arbitrability of the underlying dispute.

However, the proposition that cases involving sanctions are arbitrable is not without reservations. In a series of cases involving the application of overriding mandatory provisions of the EU law and the law of its Member States, German, Austrian and English courts found it appropriate to strike down arbitration agreements where their tentative purpose was to escape the application of such mandatory rules.⁵⁸

⁵⁶Partial Award in Case No. 6719, JDI 1994, 1071-1081.

⁵⁷ *Fincantieri Cantieri Navali Italiani SpA et OTO Melara Spa v ATF* (Switzerland, 23 June 1992) Tribunal Fédéral.

⁵⁸ Szabados (n 30) 447-448.

The German Federal Court of Justice ruled that an intention to avoid the application of German securities law was sufficient to justify the refusal to enforce both a choice of court agreement and an arbitration agreement.⁵⁹ The OLG München held that if the choice of court in favour of Californian courts and the choice of Californian substantive law were designed to avoid the EU and German rules on the protection of commercial agents, such provisions will be treated as invalid. The court applied the same logic to arbitration agreements.⁶⁰ In a similar case involving the EU Commercial Agents Directive,⁶¹ the Austrian OGH found that if the aim of an arbitration agreement was to disregard the mandatory provisions of the EU law, this would entail the invalidity of such an agreement.⁶² These decisions suggest that a similar logic would apply to arbitration agreements aiming to evade the sanctions regulation.⁶³

Likewise, in *Accentuate Limited v ASIGRA Inc*,⁶⁴ Tugendhat J held that an arbitration agreement is null and void or inoperable in so far as it purports to require the submission to arbitration in Toronto, under Ontario law, of questions pertaining to mandatory provisions of the EU law, namely the Commercial Agents Directive. It is notable that this decision was made following an arbitration award where the arbitrator declined to apply the Directive. In *Fern Computer Consultancy Ltd v Intergraph Cadworx & Analysis Solutions Inc*,⁶⁵ Mann J concluded that an English court was the proper place to determine the dispute involving the Commercial Agents Directive, and declined to give effect to the jurisdiction clause in favour of Texas courts in this context, where it was not sufficiently

⁵⁹ BGH, Urteil vom 15 June 1987 – Az. II ZR 124/86.

⁶⁰ OLG München, 17 May 2006 – 7 U 1781/06, IPRax 322 (2007).

⁶¹ Council Directive 86/653/EEC on the co-ordination of the laws of Member States relating to self-employed commercial agents (OJ No. L382. 31 December 1986, p.17).

⁶² Giesela Rühl, 'Die Wirksamkeit von Gerichtsstands- und Schiedsvereinbarungen im Lichte der Ingmar-Entscheidung des EuGH', IPRAX, 294, 299 (2007).

⁶³ Szabados (n 30) 447-448

⁶⁴ [2009] EWHC 2655 (QB) at 89.

⁶⁵ [2014] EWHC 2908 (Ch).

clear that the alternative court would give effect to the Directive. Again, there is little doubt that the same approach would apply to cases involving sanctions.

This line of authorities is not altogether surprising. As Jonathan Mance pointed out in his recent article,⁶⁶ even the seminal US Supreme Court decision in *Mitsubishi v Soler Chrysler-Plymouth*,⁶⁷ so often hailed for its pro-arbitral stance, contained the following passage on the hypothetical possibility of enforcing a clause in favour of arbitration which would disregard the US mandatory rules:

in the event that the choice-of-forum and choice-of-law clauses operated in tandem as a prospective waiver of a party's right to pursue statutory remedies for anti-trust violations, we would have little hesitation in condemning the agreement as against public policy.⁶⁸

These cases further reinforce the point already mentioned above: national governments and domestic courts will support arbitration only as long as they are reasonably confident that it will not be used as a mechanism of avoiding the application of mandatory rules, such as the economic sanctions.

One may doubt, however, whether this line of cases should properly be considered under the heading of arbitrability. It is possible to adopt this approach,⁶⁹ and the language of some of the decisions cited above is indeed broad enough for that. However, this does not accord with objective arbitrability of disputes as it is conventionally understood. Rather, what the courts seem to have done here was the case-by-case analysis of each arbitration agreement. The aim of the analysis was to determine whether the arbitration agreement violated public policy and, on this ground, was

⁶⁶ J Mance, 'Arbitral autonomy and applicable and overriding law', *Asia Pacific Law Review* (2019) 1, at 10.

⁶⁷ *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985)

⁶⁸ *Ibid.* at 636-637.

⁶⁹ Szabados (n 30) 447-448.

null and void. This approach may lead to a similar practical result as holding the disputes non-arbitrable, but it allows the courts to consider the unique facts in every case. Importantly, it avoids broad generalisations that a finding of non-arbitrability would entail. Where, having considered all the circumstances, the courts conclude that the arbitration agreement is likely to be used as a means of evading the mandatory provisions, such an agreement may be struck down. But if the parties satisfy the court that the arbitrators are likely to apply the relevant mandatory provisions, there should be no obstacle to referring them to arbitration as Article II of the New York Convention requires.

3.2. Public policy

According to Art. V of the New York Convention, recognition and enforcement of an arbitral award may be refused if the competent authority in the country where recognition and enforcement is sought finds that the recognition or enforcement of the award would be contrary to the public policy of that country. Art. 34 (2) of the UNCITRAL Model Law on International Commercial Arbitration contains a similar provision.

The public policy exception acts as an ‘emergency brake’ that the State court may use when faced with an unacceptable award. Despite the broad wording of this exception, most experts agree that in the New York Convention, as well as in domestic arbitration law, one should interpret it with caution.⁷⁰ Public policy must not be confused with public law; the former defines only the most basic, core values of the legal system.⁷¹

⁷⁰ Marike R. P. Paulsson, *The 1958 New York Convention in Action* (Kluwer Law International, 2016) 225; 225; see also the UK House of Lords decision in *Deutsche Schachtbau-und Tiefbohrgesellschaft mbH v. Ras al Khaimah National Oil Co., Shell International Petroleum Co. Ltd.* [1990] 1 AC 295.

⁷¹ V.V. Yarkov, ‘Proizvodstvo po delam o priznanii i privedenii v ispolnenie reshenii inostrannykh sudov i inostrannykh arbitrazhnykh reshenii (kratkii kommentarii k glave 31 APK)’ (2003) *Arbitrazhnyi i grazhdanski protsess* 5.

If an arbitral award contradicts a prohibition of the relevant sanction, courts will have to face a question whether they should equate the interests of the State's domestic or foreign policy and the 'public policy' as defined in the New York Convention. In the past, national courts usually drew a strict distinction and answered this question in negative, as exemplified in the US case *Parsons & Whittemore Overseas Co.*⁷² But how widely accepted is this liberal approach and does it always hold true today when national courts deal with cases involving economic sanctions?

As discussed above, the International Law Association did not hesitate to include the UN sanctions on the list of international obligations the violation of which amounts to a breach of public policy under the New York Convention.⁷³ However, the unilateral sanctions, such as those adopted by the US and the EU against Russia, or the Russian counter-sanctions, present more complex questions.

In the EU, the *Eco Swiss*⁷⁴ judgment of the CJEU established that, if a tribunal fails to apply the mandatory provisions of EU law, the courts of the arbitral seat can correct the position on review.⁷⁵ The CJEU held that Article 81 of the EC Treaty (dealing with the competition and anti-trust rules) must be regarded as a matter of public policy. The same logic will, therefore, apply to the enforcement of foreign awards under the New York Convention.⁷⁶ Since the EU sanctions by their nature are also mandatory provisions of the EU law, they would also be classified as a matter of public policy. The courts of the Member States have to apply overriding mandatory

⁷² *Parsons & Whittemore Overseas Co. v. Societe General de l'Industrie du Papier (RAKTA)*, 508 F2d 969, 977 (2d Cir 1974). See below the text accompanying note 85.

⁷³ P Mayer and A Sheppard (n 33).

⁷⁴ Case C-126/97, *Eco Swiss China Time Ltd v. Benetton International NV*, [1999] ECR I-3055.

⁷⁵ J Mance, 'Arbitral autonomy and applicable and overriding law', *Asia Pacific Law Review* (2019) 1, 7.

⁷⁶ Szabados (n 30) 459.

provisions of the EU law *ex officio*, without either party having to raise the relevant objection.⁷⁷

In Russia, the courts consistently interpret both the UN Security Council sanction programmes and the Russian counter-sanction provisions as an element of public policy. For example, when a North Korean insurer applied to enforce an *ad hoc* award against a Russian company, the court in its 2019 ruling⁷⁸ has refused the enforcement. It relied on the UN Security Council resolutions No 2270 of 2 March 2016 and No 2321 of 30 November 2016 introducing sanctions against North Korea in connection with its nuclear programme, and the respective implementing Decrees of the President of Russian Federation.⁷⁹ The court specifically referenced the sanction instruments' provision prohibiting the payment or performance of any obligation in favour of North Korea or any natural or legal person of this country. It pointed out that the underlying transactions (insurance of seagoing vessels) were prohibited by the measures in question. It is remarkable that the court apparently concluded that in this case, the contracts giving rise to the claims in arbitration rather than the payment under the awards as such violated the sanctions.⁸⁰ Arguably, the decision could have been much clearer in many respects⁸¹ – but it was certainly a step forward for the court because when it heard the case for the first time (the initial ruling was overturned by the cassation court and returned for reconsideration), sanctions did not even feature in the judgment text.

⁷⁷ I Kunda, *Internationally Mandatory Rules of a Third Country in European Contract Conflict Laws* (Rijeka Law Faculty 2007) 132.

⁷⁸ Ruling of the Krasnoyarsk Commercial Court of 18 June 2019, case number A33-17899/2018.

⁷⁹ Presidential Decrees No 729 of 29 December 2016 and No 484 of 14 October 2017.

⁸⁰ S Usoskin, 'Sanctioned Entity Cannot Enforce an Award in Russia Says the Krasnoyarsk Commercial Court' (31 July 2019) <<http://usoskinarb.com/2019/07/31/sanctioned-entity-cannot-enforce-an-award-in-russia-says-the-krasnoyarsk-commercial-court>> accessed 15 November 2019.

⁸¹ M Samoylov, 'Mezhdunarodnye sanktsii i priznanie inostrannogo arbitrazhnogo resheniya v Rossii' (8 August 2019) <https://zakon.ru/blog/2019/08/08/mezhdunarodnye_sankcii_i_priznanie_inostrannogo_arbitrazhnogo_resheniya_v_rossii> accessed 15 November 2019.

In another recent case, Ukrainian claimant obtained an arbitral award of the International Commercial Court at the Ukrainian Chamber of Commerce and Industry against two Russian companies. Confirming the lower court's decision to refuse enforcement of the award, the Commercial Court of the Moscow Circuit⁸² pointed out that the director of the applicant company was included in the sanctions list under the Presidential Decree of 22 October 2018 No 592 'On Special Economic Measures in Connection with Ukraine's Unfriendly Actions towards Citizens and Legal Entities of the Russian Federation'. It did not seem to matter much to the court that it was a director, not the company itself that was included on the list of sanctioned entities.⁸³ Perhaps the argument was not put before the court, or the court was prepared to give the Russian sanctions regulations an extensive interpretation.

The US courts are often hailed for their deferential approach when it comes to the enforcement of foreign arbitral awards involving sanctions.⁸⁴ According to the famous rule in *Parsons & Whittemore Overseas Co.*, the notion of 'public policy' must be interpreted restrictively and the enforcement of a foreign arbitral award may be refused on this ground only when it would violate the most basic concepts of morality and justice in the enforcing State. In that case, the award debtor relied on severance of diplomatic relations between the US and Egypt in connection with the Arab-Israeli armed conflict. According to the defendant, they had to withdraw from the contract for reasons of solidarity with their country's policy. The Court of Appeal rejected these objections, pointing out that the national policy of the US and 'public policy' under the New York Convention are different categories which must not be confused with each other.⁸⁵

⁸² The Decrees of the Commercial Court of the Moscow Circuit of 11.02.2019 N F05-24305/2018, case number N A40-221986/2018; and of 11.02.2019 N Ф05-87/2019 , case number N A40-221976/2018.

⁸³ Decree of the Government of Russian Federation of 1 November 2018 N 1300.

⁸⁴ Szabados (n 30) at 459; da Silveira (n 10) 122.

⁸⁵ *Parsons & Whittemore* (n 72).

Ministry of Defense of the Islamic Republic of Iran v. Gould, Inc. was one of the rare occasions when the US court refused recognition and enforcement of an arbitral award on the grounds of public policy. In that case, the Iran Ministry of War and an American contractor signed a contract for the supply of military equipment. Iranian side handed over the communication equipment necessary for the contractual performance. Upon the introduction of sanctions against Iran, the performance of the contract became impossible, and the parties submitted the dispute to arbitration. Among other things, the resulting award stipulated that the contractor had to return the equipment to Iran. However, the equipment in question was the military radio; the contractor under the then-current US law could not export it to the State that ‘repeatedly provided support for acts of international terrorism.’ For this reason, the US District Court refused the enforcement of this part of the award, adding that ‘if these restrictions are lifted within a reasonable time after this Order is entered, then the defendants must return or make available the equipment as directed by the Award.’⁸⁶ Iran appealed the decision, but on appeal, the parties settled the case. In this situation, indeed, it is hard to imagine that an act expressly prohibited by law could have received the support of US courts.⁸⁷

In a sense, the 2011 decision of the Court of Appeal for the Ninth Circuit in *Ministry of Defense of Iran v. Cubic Defense Systems* takes an intermediate position between the two situations above. In this case, the Iraqi Ministry of Defense and a US company entered into a contract for the supply of military navigation systems. In 1979, after the Iranian revolution, US sanctions had been imposed against Iran, prohibiting the export of equipment to Iran. The next instalment of sanctions also made all payments for the benefit of Iranian citizens and companies subject to authorisation by the relevant US public

⁸⁶ *Ministry of Defense of the Islamic Republic of Iran v. Gould Inc.* 887 F.2d 1357; certiorari denied, 110 S.Ct. 1319.

⁸⁷ Geisinger (n 14) 429-430.

authority. The arbitral tribunal held the hearings in Tehran, and in 1997 made a final award ordering the contractor to pay damages. The case culminated in the 2011 Court of Appeal decision. Relying on the familiar rule in *Parsons & Whittemore Overseas Co.*, the court stated that considerations of foreign policy, which includes sanctions against Iran, are not identical to public policy, and agreed with the district court's confirmation of the award. Regarding restrictions on the payment in favour of the Iranian Government, the court pointed out that the confirmation of a foreign arbitral award is not the same as payment in cash. The US Treasury Department's Office of Foreign Assets Control has the right to issue a license for the actual transfer of funds.⁸⁸ Until it does so, or until the US lifts the sanctions against Iran, one solution could be that the money would remain in a special 'blocked' account which neither of the parties will be able to access.⁸⁹

The commentators welcomed this decision as yet another confirmation that the US courts are committed to a narrow interpretation of the public policy exception.⁹⁰ However, the actual transfer of funds in favour of the claimant – which is the ultimate goal for any disputant in arbitration – never ensued. In 2013, the District Court for the Southern District of California attached the Cubic's award debt in favour of the third parties with claims against Iran. Following a few unsuccessful attempts by others,⁹¹ this happened in *Ministry of Defense of Iran v Cubic Defense Systems and Jenny Rubin et al.*⁹² The case involved an application by several US citizens who had previously obtained US court decisions compensating them for

⁸⁸ *Ministry of Def. & Support for the Armed Forces of the Islamic Republic of Iran v. Cubic Def. Sys., Inc.*, 665 F3d 1091 (9th Cir 2011).

⁸⁹ A. Akhmedov, 'Pirrova pobeda Irana' (Russian Arbitration Association, 3 June 2014) <<https://arbitration.ru/press-centr/news/pirrova-pobeda-irana>> accessed 15 November 2019.

⁹⁰ T. Cummins and James MacDonald, 'Economic Sanctions: Implications for International Arbitration', GAR (10 May 2018) <<https://globalarbitrationreview.com/editorial/1169291/economic-sanctions-implications-for-international-arbitration>> accessed 15 November 2019; Hanessian G (ed), *ICDR Awards and Commentaries, Volume 1* (Juris Publishing, 2012) 480-484.

⁹¹ The most prominent among these cases culminating in US Supreme Court decision in *Ministry of Defense and Support for the Armed Forces of the Islamic Republic of Iran v. Elahi* (April 21, 2009) 556 US. 366129 SCt 1732.

⁹² *Ministry of Def. & Support for Armed Forces of Islamic Republic of Iran v. Cubic Def. Sys., Inc.*, 984 F.Supp. 2d 1070 (SD Cal 2013). The decision was affirmed on appeal: *Ministry of Def. & Support for the Armed Forces of the Islamic Republic of Iran v. Frym*, 814 F3d 1053 (9th Cir 2016).

the damage resulting from acts of terrorism. The defendant in those previous cases was the Islamic Republic of Iran as a state supporter of terrorism. In the absence of Iran's other assets in the US, the court found it possible to attach this debt.

Thus, although on the face of it, the public policy exception was deemed inapplicable in *Ministry of Defense of Iran v. Cubic Defense Systems* and the US economic sanctions did not amount to a ground for refusing enforcement of an arbitral award, the outcome of the dispute seems perfectly compatible with the US foreign policy. The money of a US corporation that supplied military equipment to Iran was used to compensate for the damage that American citizens suffered from terrorism. The winning party in the arbitration, the Islamic Republic of Iran, spent more than a decade before the US courts but obtained no payment.

The judgments utilized to attach the *Cubic* award deserve a closer look. The money which Cubic Defense Systems owed to Iran under the terms of the arbitral award amounted only to a fraction of Iran's total debt to US citizens – victims of terrorism. Although Iran's assets in the US would otherwise have been immune from execution, the classification of Iran as a 'state sponsor of terrorism' meant that they lost their claim to sovereign immunity. The US 'terrorist exception' was specifically introduced into the Foreign Sovereign Immunities Act 1976⁹³ to deal with claims arising from overseas terrorist acts. Prior to 1996 when this exception appeared, the US courts have consistently held that the privilege of sovereign immunity could not be withdrawn on any ground when the acts in question, regardless of their atrocity, took place outside the US territory.⁹⁴ The 'terrorist exception' remains unique to the US; the majority of other countries premise the exercise of jurisdiction over

⁹³ Section 1605A (a) FSIA.

⁹⁴ See, e.g., *Cabiri v Government of Republic of Ghana* 165 F.3d 193 (1999); *Argentine Republic v Ameradi Hess Shipping Corp* 488 US 428 (1989); *Persinger v Islamic Republic of Iran* 729 F.2d 835 (DC Cir); *in Re Terrorist Attacks* 714 F. 3d 109, 116 (2d Cir 2013).

a foreign state on some connection with the territory of the forum state.⁹⁵

The attachment of the Cubic award then became possible by virtue of another statutory provision enacted by the US Congress in 2002. Section 201(a) of the Terrorism Risk Insurance Act (TRIA)⁹⁶ reads as follows:

Notwithstanding any other provision of law ..., in every case in which a person has obtained a judgment against a terrorist party on a claim based upon an act of terrorism, or for which a terrorist party is not immune [...], the blocked assets of that terrorist party (including the blocked assets of any agency or instrumentality of that terrorist party) shall be subject to execution or attachment in aid of execution in order to satisfy such judgment to the extent any compensatory damages for which such terrorist party has been adjudged liable.

‘Blocked’ assets in the provision above include assets ‘seized or frozen by the US’ under the International Emergency Economic Powers Act.⁹⁷ Overall, this legislative framework is rather peculiar. Commenting on the provisions of TRIA, a group of authors observed:

Anything related to attachment of sovereign assets is confusing and persons must double and triple check legislation, regulations, and actual and pending amendments thereto. When terrorist debtor assets are involved, issues increase geometrically. This cautionary

⁹⁵ R O’Keefe, CJ Tams and A Tzanakopoulos (eds.), *The United Nations Convention on Jurisdictional Immunities of States and Their Property: A Commentary* (OUP 2013) 210.

⁹⁶ 28 U.S.C. § 1610.

⁹⁷ 50 U.S.C. §§ 1701–1706.

comment applies most particularly to the Terrorism Risk Insurance Act.⁹⁸

The English courts may soon have to deal with a similar question. In *Ministry of Defence & Support for Armed Forces of the Islamic Republic of Iran v International Military Services Limited*,⁹⁹ the Iranian Ministry of Defence (MODSAF) obtained two arbitral awards against a government-owned English company (IMS). The dispute arose out of contracts concluded in the 1970s and terminated after the Iranian revolution. By the time the awards were issued and the proceedings to set them aside in the Netherlands (the seat of arbitration) came to a conclusion, MODSAF had been added to the list of sanctioned entities under the relevant EU Council Regulation. As it follows from the judgment, the Ministry's position was that there was no impediment to the English Court entering judgment in terms of the awards pursuant to sections 100-104 of the English Arbitration Act 1996 (the provisions implementing the New York Convention).¹⁰⁰ Phillips J, in a judgment dealing with a separate matter arising from this case (that concerning the amount of interest under the awards), noted that whether the awards are enforceable in England as a matter of principle remains to be decided at a later date.¹⁰¹ At the time of writing, this central question has not yet been decided.

This decision did, however, introduce some clarity into the English court's position on EU sanctions. The central issue before Phillips J was whether the court should refuse enforcement of any post-award interest element of the Awards in relation to the period after MODSAF became a designated entity.¹⁰² The tribunal awarded post-award interest in favour of the Ministry. However, under the EU Council Regulation, the respondent was effectively prevented from

⁹⁸ Ved P. Nanda, David K. Pansius and Bryan Neihart, *Litigation of International Disputes In U.S. Courts* (2d ed. 2018) § 3:52.

⁹⁹ *Ministry of Defence & Support for Armed Forces of the Islamic Republic of Iran v International Military Services Limited* [2019] EWHC 1994 (Comm).

¹⁰⁰ *Ibid* at 11-12.

¹⁰¹ *Ibid* at 17.

¹⁰² *Ibid* at 14.

the repayment of debt during the sanctions period. Under these circumstances, as IMS argued, it had been legally impossible to discharge the debt, and therefore the enforcement of post-award interest in relevant part was also impossible. The judgment did not consider public policy in much detail; it merely acknowledged the respondent's position that it would be contrary to public policy within the meaning of section 103(3) of the Arbitration Act 1996¹⁰³ to recognise or enforce the Awards where the EU sanctions prevented the same.¹⁰⁴ The judgment concentrated instead on the interpretation of the relevant EU sanctions instrument.¹⁰⁵ This interpretation, however, allowed the court to make an unambiguous conclusion that the accrual of interest during the sanctions period was indeed legally prevented, and therefore the post-award interest component of the arbitral awards was unenforceable. Presumably, this conclusion had to imply the reliance on section 103(3) of the Arbitration Act 1996, i.e. on public policy.

Generally, dealing with enforcement of awards in favour of sanctioned entities, English courts might take into account the following. On the one hand, the CJEU's decision in *Eco Swiss* made it clear that the violation of a mandatory rule of the EU law amounts to a violation of public policy. The commentators have interpreted this logic as extending to the enforcement of foreign awards and pointed out that economic sanctions have all the necessary requisites of a relevant mandatory rule.¹⁰⁶ On the other hand, a logic similar to that adopted by US courts in *Ministry of Defense of Iran v. Cubic Defense Systems* remains possible: if entering a judgment to enforce an arbitral award does not amount to making funds available to a sanctioned person, there may not be any violation of the sanctions regime at all.

¹⁰³ Equivalent to the New York Convention Article V(2)(b).

¹⁰⁴ *MODSAF v IMS* (n 99) at 31.

¹⁰⁵ Council Regulation (EU) No 267/2012 of 23 March 2012 concerning restrictive measures against Iran and repealing Regulation (EU) No 961/2010.

¹⁰⁶ T Szabados (n 30) 459.

Although the latest EU sanctions regulations are better developed than many of their predecessors and international counterparts, they still leave some ambiguity as to whether the making of a court order enforcing an award in favour of a sanctioned entity constitutes the ‘making of funds or economic resources available, directly or indirectly, to or for a benefit of’ that entity. This is one of the key prohibitions within the current EU sanctions regime; it is found, for instance, in Article 23 of the Council Regulation (EU) No 267/2012 of 23 March 2012. The recognition and enforcement of an arbitral award, including by way of exequatur, features in this Regulation’s definition of ‘claim’; and the definition of ‘funds’ includes, among other things, ‘claims on money’.¹⁰⁷ However, the term ‘making available’ is not defined in the Regulation as such.¹⁰⁸ Given the broad wording of the prohibition, it still seems logical to argue that, under those provisions, recognition and enforcement of an arbitral award in Europe in favour of an entity subject to such EU sanctions would be barred. However, on the level of court practice, this remains to be decided.

Intentionally or unintentionally, this might leave open the possibility of following the US (*Cubic*) approach in Europe. One could say that what takes place under such an arrangement is merely a redistribution of assets from an (English or American) company that was ‘reckless’ enough to enter into a transaction with a subsequently sanctioned entity, to another (English or American) natural or legal person with a legitimate claim against a sanctioned entity. From the policy perspective, it is not altogether clear if such an outcome would be a worse alternative than leaving the funds with the initial debtor. Of course, if the English courts are ever to apply similar logic to a sovereign State, it will be necessary to find a functional equivalent of the ‘terrorist exception’ and the TRIA statutory provisions in the English law. Without the intervention of the UK Parliament, such an

¹⁰⁷ Ibid Article 1.

¹⁰⁸ Id.

outcome seems unlikely – although not altogether improbable. Under the current law, the attempts to enforce US court judgments against Iran compensating the victims of terrorism in England so far had been unsuccessful on the grounds of sovereign immunity.¹⁰⁹ It remains to be seen whether there could exist any legal obligations enforceable in England to make the adoption of such an approach worthwhile.

4. Conclusion

As the discussion above illustrates, economic sanctions do influence the functioning of international commercial arbitration. The resolution of many complex procedural matters by arbitral tribunals depends ultimately on the prevailing position of national courts concerning the objective arbitrability of disputes involving sanctions, and their understanding of the public policy defence.

Based on the existing practice and doctrine, any impact of sanctions on arbitrability of disputes seems unjustified. The majority of courts and commentators have supported this conclusion. The known exceptions from this rule appear to be isolated, and rather evidence the unpredictability of any litigation than any consistent tendency. The line of authorities disallowing arbitration where the parties attempted to use it to avoid the application of sanctions,¹¹⁰ on the other hand, is significant and consistent, and is worth keeping in mind. However, this jurisprudence is better understood as the use of public policy to hold arbitral agreements null and void, rather than as any general pronouncement about non-arbitrability of disputes involving sanctions. Where the courts, having considered the facts of the case, are reasonably certain that the tribunal would properly

¹⁰⁹ As well as on other grounds, including service of proceedings on Iran; see *Heiser's Estate v Iran* [2019] EWHC 2074 (QB).

¹¹⁰ See above, the text accompanying note 60.

consider and apply the mandatory sanctions regulations, they will normally allow the arbitration to take its course.

The use of sanctions as a reason for refusing recognition and enforcement of arbitral awards or setting an award aside on the grounds of public policy, on the other hand, remains common. The public policy argument may be upheld, first and foremost, when the award requires a losing party to perform an action expressly prohibited by the sanctions. The mere fact of sanctions' existence and their consideration by an arbitral tribunal is insufficient to invoke the public policy exception. The courts in some countries, particularly in Russia, currently tend to give expansive interpretation to the sanctions regulations. In other jurisdictions, including the US and EU, the position is more finely balanced, but the courts nevertheless also seem prepared to strike down arbitral awards on this ground.

Parties to commercial agreements must also bear in mind that even a court decision to recognise and enforce an arbitral award, in the atmosphere of high foreign policy tension, does not in itself guarantee the payment of the award debt. As illustrated by the *Cubic Defense Systems* case discussed above, where full-scale economic sanctions coexist with the ongoing political tension, a result functionally equivalent to a denial of recognition and enforcement of an arbitral award may emerge through an alternative legal mechanism. Where the sanctioned entity is a sovereign state, the traditional defence of sovereign immunity may still provide some protection – but this rule has its exceptions, particularly in the US. The unfolding of the same scenario in Europe does not seem very likely at the moment, although cannot be excluded altogether.

Whether the enforcement of arbitral awards in favour of entities subject to EU sanctions would be barred in Europe remains to be decided in court practice. With cases such as *Ministry of Defence & Support for Armed Forces of the Islamic Republic of Iran v*

*International Military Services Limited*¹¹¹ ongoing, the position may become clearer soon. The legal status of funds in the frozen bank accounts, the interpretation of the prohibition to ‘make the funds available’ to a sanctioned entity, as well as the legal significance of the option to request a licence from a competent authority to perform an otherwise forbidden transaction, may be the key factors that could define the resolution of this issue.

As the world politics grow more polycentric and the popularity of sanctions continues to increase, the questions of arbitrability and public policy are bound to keep arising in practice. With the accumulation of the states’ regulatory experience, the newer generations of more complex sanctions regulations will undoubtedly continue to present new challenges for the global arbitration community.

¹¹¹ *MODSAF v IMS* (n 99).