

CHAPTER 8

The Impact of Unilateral Sanctions on Institutional Arbitration

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Unilateral restrictive measures (URM) are economic measures that are imposed by one sovereign state or a group of sovereign states against another state and/or its national(s), to achieve a specific foreign policy or national security objective. Commonly, URM have the express purpose of changing the policy of a foreign state by making it difficult for a specially designated national of that state (SDN) to trade with the nationals of the state which imposed URM.

An avalanche of national URM programs introduced by some states against the nationals of other states as well as counter-URM laws negatively affect global trade, and consequently, international commercial arbitration. Accordingly, to pursue its case in an international arbitration, an SDN must master an ultimate obstacle course of legal restrictions and commercial limitations, which quite often become an insurmountable impediment to “having one’s day in court.”

Difficulties may arise at each stage when an SDN:

- (a) instructs the service providers (legal counsel, expert witness, support services);
- (b) initiates arbitration proceedings and pays arbitration fees;
- (c) constitutes an arbitral tribunal;
- (d) deals with the effect of URM on an underlying commercial contract;
- (e) deals with the setting aside of an arbitral award;
- (f) pursues the recognition and enforcement of the arbitral award.

Although this list is not exhaustive, the above are probably quite common for most SDNs, irrespective of which national URM program they are designated by.

§8.01 INTRODUCTION

The twentieth century brought unprecedented growth in global trade and investments. To facilitate global trade, the international community deployed an array of legal and institutional instruments, such as free trade agreements, bilateral and multilateral investment treaties, customs unions, world and regional trade organizations, international commercial and investment arbitration and others. The main objective of all these was to ensure a free flow of goods and services at a global level. To enable global trade, the states consented to delegate part of their judiciary powers to private parties, who have been at liberty to decide how to resolve their commercial disputes. One obvious advantage of international commercial arbitration is a possibility to ensure that parties, be it the state, legal or natural person, enjoy equal and unbiased legal treatment irrespective of their size, ownership, and nationality.

The growing importance of global trade made it an important instrument of foreign policy in some states, which strived to leverage their economic powers over others. In such circumstance, unilateral restrictive measures (URM) became a tool for projecting national foreign state policy internationally, in other words, a tool of strategic communication of national interests. While the global economy was on the rise, URM were imposed mainly in response to political events abroad.

However, together with global economic decline in recent years, international trade competition has intensified. Arguably, now URM are also used as an instrument for projecting national economic interests outward.

Indeed, in the past two decades, the use of URM increased exponentially. For example, from 2014 to date, around five hundred Russian companies have been designated by the U.S. alone under various national sanctions programs. Although it was said to be done in response to certain political events, one could notice that many designated companies are visible international competitors in research and engineering, biotech, aerospace, military, manufacturing and production, construction, agriculture, banking, energy, mining and other sectors. A similar situation concerns some of the leading Chinese companies, the number of which has also grown in the past years.

Today, the body of different national URM programs has become the Great Barrier Reef of global trade, with its dangerous currents, sharp reefs, and deceptively beautiful predators. To be able to navigate in these dangerous waters, a diligent person needs to employ a sophisticated compliance apparatus. The current situation harms global trade and consequently international arbitration. This chapter discusses the impact of URM on arbitration as a global system for the resolution of commercial disputes, and possible ways for mitigating URM-related risks.

§8.02 INTERNATIONAL CRITICISM OF UNILATERAL RESTRICTIVE MEASURES

URM are economic measures that are imposed by one sovereign state or a group of sovereign states against another state and/or its national(s), to achieve a specific

foreign policy or national security objective. Commonly, URM have the express purpose of changing the policy of a foreign state by making it difficult for a specially designated national of that state (SDN) to trade with the nationals of the state which imposed URM.

URM emanate from national foreign policy or national security objectives of an individual state, and therefore they are not based on international consensus. Consequently, URM lack international (universal) legitimacy because they do not pass a so-called *shared-values-test* which would make them shared and accepted universally:

[a] common feature of sanctions is the label of “unfriendliness”. Most of them will be issued in breach of rules of international law and in violation of the notion of free trade between states and individuals. The issue therefore does arise as to their justification in law.¹

URM are issued not only in breach of rules of international law but also without meeting the basic standards of proof. A lot has been said about the decision-making process for including a person in an SDN list, which is often arbitrary and has a considerable degree of subjectivity and politization in the standards of proof. Indeed, when a state designates a foreign national under its URM program, it usually does so without providing any compelling evidence:

what amount of evidence is required in order for a designation under a U.S. economic sanction program to occur? For example, there is no statute or regulation that states, OFAC will only designate individuals based on clear and convincing evidence. That means that OFAC may designate an individual or entity at their discretion. In theory, although unlikely, so much as a rumor or an anonymous tip could lead to a designation.²

Insofar as no evidence is required, the URM designations essentially employ the same standard of proof as the Salem witch trials:

Hearsay is not, however, the only category of evidence that we now generally ban but that found a welcoming home at the Salem witch trials. The court also accepted evidence about the bad or suspicious character of the defendant. The evidence came in all forms (reputation, opinion, and allegations of specific acts) and recounted everything from unpleasant personal interactions to vicious rumors.³

Regretfully, it is a return to the Dark Age of the law.

Furthermore, the URM regulations are usually worded in a vague language which not only makes it difficult to establish the true meaning and effect of URM but also undermines the principle of legal certainty, which is one of the fundamental pillars of law. Uncertainty in the wording of URM regulations complicates the compliance process. In such circumstance, many avoid transactions with SDNs to eliminate said

1. Marc Blessing, Impact of the Extraterritorial Application of Mandatory Rules of Law on International Contracts (Helbing & Lichtenhahn 1999), p. 19.

2. Erich Ferrari, OFAC Director Offers Distinctions If Not Evidence. <https://sanctionlaw.com/ofac-director-offers-distinctions-if-not-evidence/#.XXVx9RheOT9>.

3. Len Niehoff, Proof at the Salem Witch Trials. https://www.americanbar.org/groups/litigation/publications/litigation_journal/2020-21/fall/proof-salem-witch-trials/.

risk, even if a proposed transaction is in fact permitted. This is a common issue with commercial banks, which may refuse money transfers just because a payor is designated under a URM program albeit not being binding on the bank. In such circumstances, banks usually do not burden themselves with an in-depth legal analysis of URM regulations and simply decline transactions.

Precisely because URM are unilateral, lack objectivity, and are often unclear, they receive criticism from international community. Several United Nations (UN) reports have emphasized that URM are impermissible under international law; they are:

“considered to be violations of the principles of the Charter of the United Nations, the norms of international law and the rules-based multilateral trading system”⁴ and that “the international community views as unlawful those unilateral coercive measures the extraterritorial effects of which affect the sovereignty of other States, the legitimate interests of entities or persons under their jurisdiction and the freedom of trade and navigation.”⁵

URM are also under heavy criticism by the UN General Assembly,⁶ the UN Human Rights Council⁷ and other international organizations.

Finally, URM are commonly criticized by states. For example, when the U.S. imposed URM against Russian nationals, the members of the UN refuted the imposition of the unilateral economic sanctions. Among others, China stated that “China is opposed, as always, [...] to the use of unilateral sanctions, or the threat of the use of sanctions freely in international relations”;⁸ Argentina—“we reject initiatives that seek to isolate one of the parties or impose unilateral economic sanctions that undermine the conditions that could lead to a dialogue that has become very urgent”;⁹ Nicaragua—“Because we want peace and believe in the prevention and resolution of conflicts by peaceful means, we reject all unilateral methods, such as political or economic sanctions against the Russian Federation, as they violate international law and do not contribute to easing the tense atmosphere.”¹⁰

Consequently, there is a wide consensus that URM do not amount to transnational public policy and that they are illegal under international law.

4. Report of the UN Secretary-General “Unilateral economic measures as a means of political and economic coercion against developing countries” No. A/70/152 dated July 16, 2015, para. 5.

5. Report of the UN Special Rapporteur on the negative impact of unilateral coercive measures on the enjoyment of human rights No. A/HRC/42/46 dated July 5, 2019, para. 46.

6. UN General Assembly Resolution No. 2625 (XXV) dated October 24, 1970, Declaration on Principles of International Law concerning Friendly Relations and Cooperation among States in accordance with the Charter of the United Nations, p. 123 “no State may use or encourage the use of economic, political or any other type of measures to coerce another State in order to obtain from it the subordination of the exercise of its sovereign rights”; UN General Assembly Resolution No. 3281 (XXIX) dated December 12, 1974, containing the Charter of Economic Rights and Duties of States, which in its Article 32 calls upon all states to refrain from any unilateral coercive measure not in accordance with international law and the Charter of the United Nations.

7. Report of the UN Special Rapporteur on the negative impact of unilateral coercive measures on the enjoyment of human rights No. A/HRC/42/46 dated July 5, 2019, para. 46; Human Rights Council Resolution No. A/HRC/RES/30/2 dated October 12, 2015, preamble, para 3.

8. UN Security Council Meeting. S/PV.7576, p. 19.

9. General Assembly 80th plenary meeting (A/68/PV.80), p. 20.

10. General Assembly 80th plenary meeting (A/68/PV.80), p. 13.

URM shall not be confused with international sanctions. As opposed to URM, international sanctions are political and economic measures based on a wider international consensus and are imposed by international organizations against states or organizations to protect international law and maintain or restore international peace and security. For example, international sanctions may be imposed by the UN Security Council under Article 41 of the UN Charter. They are defined as measures not involving the use of armed force, which may include complete or partial interruption of economic relations and of rail, sea, air, postal, telegraphic, radio, and other means of communication, and the severance of diplomatic relations.¹¹ Since 1966, Article 41 of the UN Charter was applied only in exceptional circumstances, and it was always a prevailing majority decision by the UN Member States. In the past six decades, the Security Council has established thirty sanctions regimes, in Southern Rhodesia, South Africa, the former Yugoslavia (2), Haiti, Iraq (2), Angola, Rwanda, Sierra Leone, Somalia and Eritrea, Eritrea and Ethiopia, Liberia (3), DRC, Côte d'Ivoire, Sudan, Lebanon, DPRK, Iran, Libya (2), Guinea-Bissau, CAR, Yemen, South Sudan and Mali, as well as against ISIL (Da'esh) and Al-Qaida and the Taliban.¹²

A distinction between international sanctions and URM bears practical importance, especially when arbitral tribunals are asked to interpret the notion of “public policy.” While violation of international sanctions may result in violation of national public policy of a sovereign state, violation of URM imposed by one state does not necessarily lead to violation of national public policy of another sovereign state. That is because each state has a distinct national public policy and may use a different toolbox to achieve its sovereign objectives. As a result, URM programs of different states, even against the same SDNs, differ significantly.

For example, on July 4, 2019, the authorities of Gibraltar detained the Iranian supertanker *Grace 1* on suspicion of supplying oil to Syria. The detention ended on August 15, 2019. On August 16, 2019, U.S. court issued a warrant for the seizure of the tanker on the grounds that it had links to Iran’s Islamic Revolutionary Guard Corps, which the U.S. have designated as a “terrorist” organization. The U.S. sent a Supplemental Mutual Legal Assistance request to Gibraltar providing information in support of its application to prevent the departure from Gibraltar of *Grace 1* and its cargo of oil, in anticipation of forfeiture proceedings to be commenced in the U.S. On August 18, 2019, the Gibraltar Central Authority informed that it was unable to seek an Order of the Supreme Court of Gibraltar to provide the restraining assistance required by the U.S. because:

“The Central Authority’s inability to seek the Orders requested is a result of the operation of European Union law and the differences in the sanctions regimes applicable to Iran in the EU and the US” and also because “The EU sanctions regime against Iran—which is applicable in Gibraltar—is much narrower than that

11. Article 41, Chapter VII of the Charter of the United Nations.

12. <https://www.un.org/securitycouncil/sanctions/information>.

applicable in the US” and that “This is a reflection of the very different positions and legal regimes in the US and the EU.”¹³

This is one of many examples which demonstrates that: (a) there is no universal acceptance of URM; and (b) URM of one state shall not become mechanically binding in the territories of other nations or on foreign nationals. Considering the unjustified and hostile nature of URM, some targeted states have introduced counter-URM mechanisms to protect their nationals from negative impact of URM.

§8.03 EU’S COUNTER-SANCTIONS MECHANISM

To counter the negative effects of URM, some states introduce counter-sanctions’ mechanisms to protect their economic interests. One of such examples is the European Union (EU) Blocking Statute, which makes it illegal for EU companies to comply with certain extraterritorial URM imposed by the U.S.¹⁴ The EU Blocking Statute was originally passed in 1996 in response to illegal extraterritorial United States (U.S.) sanctions on Cuba, specifically the Helms-Burton Act, which codified and expanded the U.S. embargo on Cuba, and the Iran and Libya Sanctions Act which imposed URM on these states. The recitals of the Blocking Statute are self-explanatory:

Whereas a third country has enacted certain laws, regulations, and other legislative instruments which purport to regulate activities of natural and legal persons under the jurisdiction of the Member State;

Whereas by their *extra-territorial application such laws*, regulations and other legislative instruments *violate international law* and impede the attainment of the aforementioned objectives [emphasis added].

The EU Blocking Statute has been of some use. For example, in 2007, the Austrian government charged an Austrian bank with violating the Blocking Statute when it canceled bank accounts for Cuban citizens as part of its acquisition by a U.S. hedge fund.

On June 6, 2018, the European Commission revived the EU Blocking Statute, to give it a new life by extending the Blocking Statute to the sanctions the Trump administration brought back when it exited the Joint Comprehensive Plan of Action, also known as the Iran deal. Section 1 of the Explanatory Note reads that the EU Blocking Statute:

constitutes an important achievement of unified EU action against the *unlawful effects of extra-territorial legislation* of third countries;

13. Official Statement of Government of Gibraltar to Further Mutual Legal Assistance Requests from the United States of America. <https://www.gibraltar.gov.gi/press-releases/further-mutual-legal-assistance-requests-from-the-united-states-of-america-6042019-5198>.

14. European Council Regulation (EC) No. 2271/96 Protecting against effects of the extraterritorial application of legislation adopted by a third country, and actions based thereon or resulting therefrom, dated November 22, 1996.

The Blocking Statute applies with regard to the extra-territorial legislation mentioned in its Annex ('listed extra-territorial legislation'), which currently consists of U.S. measures concerning Cuba and Iran (emphasis added).¹⁵

It is yet to be seen how the EU Blocking Statute will develop in the future and which URM programs it may counter in addition to those already listed.

§8.04 RUSSIAN COUNTER-SANCTIONS MECHANISM

Another example of countering URM through national protective regulations is the new Russian law (Law), which extends exclusive jurisdiction of Russian state courts over certain types of disputes and parties affected by URM. The Law was adopted on June 8, 2020, as the "The law amending the Arbitrazh Procedure Code for the purposes of protecting private and legal persons from restrictive measures enacted by a state, union of several states, or a public body of a state or a union of several states." The law was enacted as the new Articles 248.1 and 248.2 of the Arbitrazh Procedure Code (APC).

The Law appears to be a reaction to the anti-Russia URM, which have been introduced against Russian legal and private persons by several states. As of today, around 690 Russian companies and individuals have been designated by the U.S. and 120 by the EU. The number of persons has been continuously growing and URM programs have affected some of the important fields of Russian economy.

[A] Definition of Restrictive Measures

Although the Law is believed to be a reaction to the anti-Russia URM, its scope is broader than it may seem. The Law employs a broad definition of "restrictive measures" ("*меры ограничительного характера*"), which may be interpreted much wider than just unilateral trade sanctions. For example, visa restrictions, administrative or criminal restrictions, economic and trade quotas, tariffs, and other unilateral restrictions may theoretically fall within the meaning of the "restrictive measures." Such restrictive measures may originate from a state, union of several states, or a public body of a state or a union of several states. Apparently, the Law does not apply to cases in which the restrictive measures were enacted by international organizations.

[B] Types of Disputes

The Law applies to disputes which may be referred by parties as a result of an international treaty or parties' agreement to arbitral tribunals and courts located outside Russia. Such cases may concern two groups of disputes.

15. European Commission Guidance Note. Questions and Answers: adoption of update Blocking Statute (2018/C 277 1/03).

The first group of disputes involves parties which have become subject to restrictive measures (“a party-based test”). The Law explains that such party (“Designated Party”) may be:

- (a) a Russian legal or private person, who was designated under the primary restrictive measures; or
- (b) a foreign legal person, who was designated under the secondary restrictive measures arising out of the primary restrictive measures against a Russian legal or private person.

The second group of disputes involves Russian or foreign persons. Such disputes shall arise out of restrictive measures against Russian persons (“a subject matter-based test”).

Potentially, the Law can make Russia a suitable forum for URM-related disputes between foreign parties. However, such disputes shall arise out of contracts impacted by anti-Russia URM. For example, a dispute between Asian and European parties arising out of a subcontract for construction of a factory in Africa owned by a Russian company could fall within the exclusive jurisdiction of Russian courts if the subject matter of the dispute arises out of URM against the Russian company.

[C] Exclusive Jurisdiction of Russian Courts

The Law provides that parties may refer their disputes to the Russian state commercial court (Arbitrazh court) where private or legal persons are domiciled. For example, if a party is located in Moscow, then the Arbitrazh (Commercial) Court of Moscow will have exclusive jurisdiction.

The Law, however, limits the scenarios when a case may fall within the exclusive jurisdiction of Russian courts. Parties may refer a dispute to the Russian court only if:

- (a) there is no case with the same subject matter and between the same parties already pending before a foreign commercial arbitral tribunal or a foreign state court;
- (b) the dispute resolution agreement between parties to refer their disputes to a foreign commercial arbitral tribunal or a foreign state court is unenforceable because one of the parties’ access to justice is denied due to restrictive measures.

[D] Recognition and Enforcement of Arbitral Awards

If a Designated Party acted as claimant, or, if acted as respondent it did not object to a foreign arbitration or litigation while it was pending, or if the Designated Party did not seek an anti-suit injunction from the Russian court against the initiation or continuation of a foreign arbitration or litigation, such foreign arbitral award or foreign court judgment shall be generally enforceable.

[E] Anti-suit Injunctions

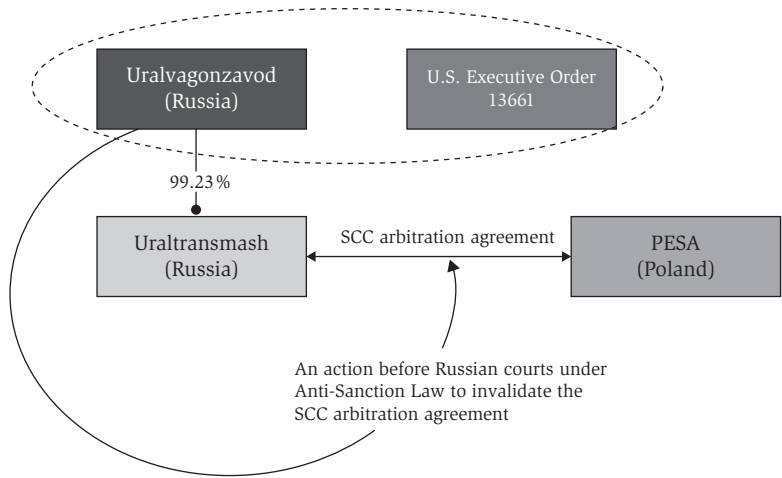
The Law also provides for a new procedural instrument, which was not previously available under Russian law, i.e., anti-suit injunctions. A Designated Person who has become or may become a party to a foreign arbitration or litigation may seek for a Russian court to issue a prohibition to the other party to initiate or continue a foreign arbitration or litigation procedure. The applications are considered by a sole judge, whose ruling may be appealed to a cassation instance within one month. The judge may also award compensation to a Designated Party for a breach of the anti-suit injunction in an amount not exceeding the amount of the relief sought from a foreign arbitration or litigation tribunal and legal costs.

[F] Russian Case Law

The application of the Law was recently considered by Russian courts in a declaratory action brought by JSC NPK Uralvagonzavod (Uralvagonzavod). In 2014, Uralvagonzavod was designated by the U.S. as SDN under the U.S. Executive Order 13661. OJSC Uraltransmash (Uraltransmash) is a leading machinery manufacturer in Russia, owned by Uralvagonzavod (99.23 %).

Uraltransmash came into contact with PESA Bydgoszcz SA from Poland (PESA) for the supply of tram carriages for the Moscow transport network. The contract contained an arbitration clause pursuant to which “all disputes arising out of the performance of the present contract shall be resolved in the Arbitration Institute of the Stockholm Chamber of Commerce” (SCC).

In 2018, Uralvagonzavod filed a derivative claim on behalf of its subsidiary Uraltransmash, requesting the court to declare the arbitration agreement between Uraltransmash and PESA invalid and unenforceable.



PESA initiated arbitration proceedings under the Arbitration Rules of the SCC pursuant to the arbitration agreement between the parties. Allegedly, due to the U.S. sanctions against its majority shareholder (Uralvagonzavod), Uraltransmash was unable to lodge its share of the arbitration fees to the SCC. It was argued that EU Council Decision No. 2014/512/CFSP dated 31 July 2014 and EU Regulation No. 833/2014 dated 31 July 2014 prohibited EU banks from accepting payments from certain Russian banks.

Furthermore, it was argued that it was impossible to instruct a legal counsel because most of the law firms refused to take instructions due to the SDN status of Uralvagonzavod.

Both the Court of First Instance and the Court of Appeal rejected Uralvagonzavod's claim. However, the Court of Cassation issued a ruling in favor of Uralvagonzavod and held that the lower courts failed to fully analyze the arguments of enforceability of the arbitration agreement. As a result, the Court of Cassation quashed the judgments of the lower courts and transferred the case back to the Court of First Instance for a new trial.

Most importantly, the Court of Cassation held that the Court of First Instance shall take into consideration Articles 248.1 and 248.2 of APC, according to which Russian state courts have exclusive jurisdiction to resolve disputes which involve Designated Parties. The court also noted that Russian courts may also issue anti-suit injunctions prohibiting to initiate or continue arbitration proceedings. In the process of reconsideration of the case by the Court of First Instance, Uralvagonzavod insisted that the arbitration clause is unenforceable because Uralvagonzavod was prevented from paying its share of the arbitration fees to the SCC and was unable to instruct a local legal counsel. The claimant also pleaded that a prospective arbitral award may be unjust due to the possible partiality of the arbitrators based on the designation of Uralvagonzavod.

PESA disagreed and indicated that the provisions of Articles 248.1 and 248.2 of the APC did not prevent the parties from arbitrating under the SCC Arbitration Rules.

PESA also pleaded that the arbitration clause is enforceable since Uralvagonzavod is successfully exercising its rights in the pending process before the SCC. Furthermore, the imposition of sanctions on Uralvagonzavod does not prejudice its rights to a fair trial in the SCC.

The Court of First Instance stated that for the application of Article 248.1 of the APC RF, a party must prove the circumstances preventing consideration of the dispute in arbitration.

In relation to Uralvagonzavod's references to EU Council Decision No. 2014/512/CFSP and EU Regulation 31 July 2014 No. 833/2014, the Court of First Instance indicated that the contract between the parties concerns supply of trams and does not belong to the categories of transactions prohibited by these documents.

The court also rejected Uralvagonzavod's argument on the impossibility of obtaining qualified legal assistance because Uralvagonzavod had a Russian legal representative and Polish legal experts. As for the obstacles in arranging payments to the Polish legal representatives, Uraltransmash unsuccessfully tried to make a transfer

through Raiffeisen Bank in Vienna. Uraltransmash could use other banks to make the transfer, but it did not try.

Regarding Uralvagonzavod's arguments on the impossibility of paying the SCC arbitration fee due to the sanctions, the court concluded that Uralvagonzavod made numerous payments to a PESA's bank account in a Polish bank within the past five years while being under the sanctions.

The court found that the U.S. and EU sanctions laws did not prohibit the SCC from accepting payments from Uraltransmash. According to the clarifications received from the Secretary-General of the SCC in August 2020, the SCC was of the opinion that the laws did not contain any instructions which oblige Uraltransmash to apply to Swedish state authorities for obtaining permission to make payments in connection with the arbitration proceedings. The SCC also indicated that in the current circumstances there were no obstacles for Uralvagonzavod to take part in the arbitration.

The court also rejected Uralvagonzavod's argument that the U.S. restrictive measures were effective throughout the EU due to their "extraterritoriality" because Uralvagonzavod did not provide any evidence that the laws and orders of the U.S. President were binding on Sweden or the EU.

Uralvagonzavod's allegations of possible impartiality of the arbitrators have not been accepted by the court either.

Consequently, the Court of First Instance ruled in favor of PESA and specifically said that Uralvagonzavod did not present evidence confirming the existence of circumstances impeding the consideration of the dispute of the SCC.

Although the Court of First Instance refused to accept jurisdiction under the Law, the court has formulated the test for admitting cases for trial—there should be compelling evidence that a Designated Party was unable to pursue its case in arbitration.

§8.05 CHINESE COUNTER-SANCTIONS MECHANISM

On January 9, 2021, the Ministry of Commerce of the People's Republic of China (MOFCOM) published the "Rules on Blocking Unjustified Extraterritorial Application of Foreign Legislation and Other Measures" (Rules).¹⁶

Article 2 of the Rules provides that they apply to situations where the extraterritorial application of foreign legislation and other measures, in violation of internal law and the basic principles of international relations, unjustifiably prohibits or restricts a citizen, legal person or other organization of China (PRC person) from engaging in normal economic, trade and related activities with another state, or person of that state. In such situations, the PRC person must report it to MOFCOM within thirty days of the situation arising (Article 5).

16. Order of the Ministry of Commerce of the People's Republic of China No. 1, on Rules on Counteracting Unjustified Extraterritorial Application of Foreign Legislation and Other Measures. January 9, 2021.

Under Article 6 of the Rules, MOFCOM should establish a task force to assess the extraterritorial application of URM, and in doing so will take into account:

- whether international law or the basic principles of international relations are violated;
- potential impact on China’s national sovereignty, security and development interests;
- potential impact on the legitimate rights and interests of the PRC persons; and
- other relevant factors.

If upon assessment MOFCOM finds unjustified extraterritorial application of foreign legislation and other measures, it will issue a prohibition order against recognition, enforcement and compliance with relevant foreign URM.

Pursuant to Article 9 of the Rules, if a person complies with foreign legislation and other measures within the scope of a prohibition order, and thus infringes upon the legitimate rights and interests of a relevant PRC person, the latter may institute legal proceedings in a people’s court, and claim compensation.

Furthermore, if a judgment or ruling made in accordance with a foreign URM within the scope of the prohibition order causes losses to a PRC person, the latter may institute legal proceedings in a people’s court, and claim for compensation by a person who benefits from said judgment or ruling.

Where a person (counterparty) refuses to execute an effective judgment or ruling made by the people’s court, the PRC person may apply to people’s court for enforcement in accordance with law.

§8.06 THE IMPACT OF URM ON INTERNATIONAL ARBITRATION

An avalanche of national URM programs introduced by some states against the nationals of other states as well as counter-URM laws negatively affect global trade, and consequently, international commercial arbitration. Accordingly, to pursue its case in an international arbitration, an SDN must master an ultimate obstacle course of legal restrictions and commercial limitations, which quite often become an insurmountable impediment to “having one’s day in court.”

Difficulties may arise at each stage when an SDN:

- (a) instructs the service providers (legal counsel, expert witness, support services);
- (b) initiates arbitration proceedings and pays arbitration fees;
- (c) constitutes an arbitral tribunal;
- (d) deals with the effect of URM on an underlying commercial contract;
- (e) deals with the setting aside of an arbitral award;
- (f) pursues the recognition and enforcement of the arbitral award;

Although this list is not exhaustive, the above are probably quite common for the most SDNs, irrespective of which national URM program they are designated by.

[A] Instructing a Legal Representative

The journey kicks off with instructing a legal representative. For example, if an SDN is targeted by the EU, instructing a counsel in the EU may become difficult, if not impossible. Even if an SDN is not targeted by the EU but has been included in the U.S. URM, those law firms which have presence in the U.S., have U.S. nationals as employees or even have U.S. clients, would likely refuse from acting for the SDN.

As a first step, an SDN may approach several law firms. At this stage, the SDN informs the prospective legal counsel of its SDN status and may disclose some information about the case and identity of the counterparty. While some law firms may immediately refuse to be involved, others will carry out an internal compliance check and may eventually require obtaining a state license to represent the client. Understandably, an application for a URM license would require disclosure of information about the parties, contract and dispute, which on its own may harm both parties. The process may take from several weeks to several months and, as a result, the list of potential legal counsel reduces from a dozen to just a few. As the options are limited, often the choice of a legal representative is truncated, vis-à-vis the choice available to the counterparty. Eventually, it cannot be excluded that the SDN will eventually fail to instruct a qualified legal counsel.

In addition, SDNs may be subject to stricter payment terms under various URM programs. For example, some of the URM limit repayment terms under loans (credits) to fourteen days. To avoid allegations of violation of URM, law firms may want to ensure that their services are not credited for longer than fourteen days and therefore frequently invoice SDNs. Consequently, it increases administrative work on the part of law firms and clients.

[B] Instructing an Expert Witness

Expert witnesses (or experts) are commonly used in international arbitration to address legal, accounting, technical and other issues. According to the 2012 International Arbitration Survey: Current and Preferred Practices in the Arbitral Process, “On average, expert witnesses are involved in two-thirds of arbitrations.”¹⁷ Furthermore, “in the vast majority of arbitrations, expert witnesses are appointed by the parties (90%) rather than by the tribunal (10%).” Thus, it is a predominant practice that expert witnesses are appointed by parties, not by the tribunal.

Naturally, an SDN which intends to instruct an expert mainly faces similar problems to those when instructing a legal counsel. Again, URM may limit the pool of available candidates, increase time and costs.

One of the common issues which may be put before legal experts is the effect of URM on commercial contracts. For example, if U.S. URM is at the heart of a dispute,

17. 2012 International Arbitration Survey: Current and Preferred Practices in the Arbitral Process, p. 29. http://www.arbitration.qmul.ac.uk/media/arbitration/docs/2012_International_Arbitration_Survey.pdf.

that will require a U.S. qualified and experienced lawyer to act as expert. Under Title 31 of the Code of Federal Regulations §589.506(a)(1), U.S. nationals are permitted to advise on compliance with and the requirements of U.S. law.¹⁸ However, §589.506(a) does not extend to expert testimony in foreign courts or arbitral tribunals on behalf of an SDN without obtaining a license from the Office of Foreign Assets Control (OFAC). In practice, OFAC mostly denies applications for such licenses. In these circumstances, SDNs often try to instruct a non-U.S. person (not a national or a resident of the U.S.), however, who holds a U.S. law degree, has URM-related experience, and has no conflict of interest. It is evident that a search for a legal expert with such qualifications may prove to be difficult. Sometimes, the only practical solution is to dispose of party-appointed experts and ask the arbitral tribunal to appoint its own expert.

Therefore, if an SDN envisages difficulties, it may be worth exploring the idea of tribunal-appointed experts with an arbitral tribunal and the opposite party at the outset of the proceedings.

[C] Procurement of Auxiliary Services

In addition to legal and expert services, parties may also require case support services, e.g., interpreters, court reporters, providers of hearing equipment, hearing facilities, hearing bundles and others. Although these contractors may not look like the most critical element of the arbitration process, usually they are procured as a matter of urgency, and very often not so long before the evidentiary hearing. In such circumstance, one needs to factor in additional time which will be required for supporting contractors to perform compliance checks.

To avoid delays in the proceedings, upon request of parties, an arbitral tribunal may engage directly with service providers to exclude any URM-related issues from the picture. This is something parties and an arbitral tribunal may want to discuss when agreeing on the procedural rules set out in Procedural Order No. 1.

[D] Commencing an Arbitration under the Institutional Arbitration Rules

As a general rule, to initiate the arbitral proceedings under the rules of an arbitral institute (AI), a claimant must file a request for arbitration and pay a registration fee. If an AI is located in a state which has imposed URM against the claimant, it is bound to comply with them. If an AI is not located in or connected with a state which imposed URM, it may want to perform a compliance check to ensure that it does not manifestly violate any URM, which may expose it to penalties or secondary sanctions of a third state. For example, U.S. Executive Orders which impose URM are binding upon “U.S. persons” (U.S. nationals and residents). Because some of the leading European AIs have U.S. persons in their governing bodies and case management teams, it may expose them to the effect of U.S. URM. To avoid such exposure, AIs may employ a “ring

18. https://www.ecfr.gov/cgi-bin/text-idx?node=pt31.3.589&rgn=div5#se31.3.589_1506.

fencing” mechanism by excluding U.S. persons from the decision-making and management of SDN-related cases. For the same reason, an AI may use the currency of a nonsanctioning state to avoid exposure to the financial system of a sanctioning state, such as payments in euro used by the International Chamber of Commerce (ICC).

In 2015, the ICC, London Court of International Arbitration (LCIA) and SCC issued a joint statement on the potential impact of EU sanctions against Russia on international arbitration administered by EU-based institutions. All three arbitration institutes concluded that “A person or entity designated by the EU Regulations is not per se prevented from filing a request for arbitration with the ICC, LCIA or SCC,” with the caveat that a designated person or entity is advised to inform the institution of a dispute prior to the request for arbitration, to enable the institutions to discuss with the parties any additional administrative requirement that needs to be fulfilled by either the parties or the institution, for example, filing an application with the relevant national authorities for an exemption under the sanction regulation.¹⁹

The joint statement by the leading AIs surely gave some comfort to the Russian companies. Indeed, the 2016 Russian Arbitration Association’s Survey on the Impact of Sanctions on Commercial Arbitration (2016 RAA Sanctions Survey) revealed that although some users have already had problems with some AIs, the majority continued to place trust in institutional arbitration at large.²⁰ However, there were some skeptics, who questioned AIs’ ability to ensure sustainable administration of SDN-related disputes.

Over the years, the number of skeptics grew, mainly because of their personal experience with AIs. The difficulties primarily related to the lengthy process of obtaining licenses to administer cases by AIs and problems with payment of the arbitration costs to AIs.

Another important consideration is confidentiality. When seeking state permission to administer SDN-related cases, AIs disclose information about the parties, underlying contracts and relevant information about transactions to the state authorities which are responsible for enforcement of URM. Having in mind a high degree of subjectivity and politization of the standards of proof on the part of URM enforcing state bodies, the risk of penalties and secondary sanctions increases dramatically. Therefore, some parties may consider it risky to use institutional arbitration and consider alternative means of dispute resolution, such as ad hoc arbitration.

With that in mind, some of the leading Russian companies (also non-SDNs) have been reconsidering their traditional preferences in arbitration, which have been shaping over decades. Presumably, the change in arbitration preferences will be visible in AIs’ annual statistics in the foreseeable future.

By far, the main impediment for institutional arbitration is receiving payments of arbitration costs from SDNs. Even if a money wire is executed in a nonsanctioned currency, banks’ compliance departments usually do not allow money transfers

19. https://sccinstitute.com/media/80988/legal-insight-icc_lcia_scc-on-sanctions_17-june-2015.pdf.

20. <https://arbitration.ru/upload/medialibrary/e1e/2016-raa-survey-on-sanctions-and-arbitration.pdf>.

originating from or relating to SDNs. For example, a local German bank will likely refuse a payment in EUR from a Russian SDN designated under U.S. URM (even if not designated under EU URM). The reason is simple; a bank does not want to take the risk of penalties or the risk of secondary sanctions from the U.S. authorities (OFAC). Ultimately, not having received a claimant's payment of the registration fee or arbitration costs, an AI will discontinue the arbitration pursuant to its arbitration rules.

There have been numerous examples when AIs were unable to arrange for a bank which would accept payments from SDNs. It goes without saying that an AI may face similar problems when returning to parties unused funds from the arbitration costs after the case was completed.

To conclude, payment of arbitration costs is an Achilles heel of institutional arbitration. Commonly, AIs are fixed to their local banks and refuse exploring other payment options. Considering the rapid expansion of URM programs across the globe, URM present a potential risk to many notable market players—there is no guarantee that a person will not be designated as SDN in the future.

Usually, this issue is considered at the stage of drafting a contract. There is an array of contractual tools for minimizing negative effects of potential URM, including alternative dispute resolution clauses (waterfall clauses), currency and payment terms, which enable a party to arbitrate its future contractual claims irrespectively of its SDN status.

However, there is a growing number of SDN-related cases which hover as a result of AIs' payment problems. That raises several important questions.

First, if an AI refuses to administer a case brought by an SDN, what is the effect on the arbitration agreement? Would the arbitration agreement become inoperable, unenforceable, invalid or else? Consequently, can an SDN disregard the arbitration clause and pursue its claims in the court of law, and if yes, in which court? For example, Russian and Chinese counter-sanction laws permit SDNs to disregard arbitration agreements and apply to local courts as if there were no arbitration agreements in place.

Second, if a respondent-SDN intends to bring a counterclaim or a set-off claim, but an AI fails to accept the payment of arbitration fees, what is the effect on the counterclaim or set-off claim and the arbitration agreement? To some extent, this may be resolved by shifting payment obligations onto the other party in arbitration, which is however not always an optimal solution.

Third, if an arbitration agreement is deemed to be unenforceable in connection with the agreed AI's procedures, does it make the parties' intention to arbitrate (as opposed to litigate) unenforceable too? In other words, should the parties still apply their best efforts to arbitrate their dispute, for example, in an ad hoc setup?

Fourth, if an AI fails to administer an SDN-related case, does it amount to a breach of contract by the AI? Indeed, when the parties to an arbitration agreement consent to refer their disputes to a particular AI, they accept the AI's unilateral contract expressed in its arbitration rules. Pursuant to its own arbitration rules, the AI guarantees that it will administer the case.

Fifth, if an AI fails to administer an SDN-related case, does it lead to the AI being liable? Most arbitration rules contain limitation of liability provisions; however, such provisions usually concern “any act or omission in connection with the arbitration.”²¹ Under many arbitration rules, arbitration commences after an AI receives a request for arbitration and the full amount of registration fee. Formally speaking, at any time before commencement of arbitration (including before payment of registration fee), there is no arbitration. Therefore, it is not obvious whether the limitation of liability provisions in the arbitration rules encompasses pre-arbitration liabilities of the AIs.

Each of these questions requires parties’ consideration at the time of drafting an arbitration agreement. As noted above, to some extent, the problem is resolved through “waterfall” clauses, pursuant to which parties may agree on several possible options of AIs, and if one option does not work, they move to another. Such multitier arbitration clauses require careful drafting to avoid parallel proceedings. Another solution is to opt for ad hoc arbitration, which is more flexible than institutional arbitration. Also, for these reasons, in recent years, ad hoc has gained popularity.

As to AIs, there is a possibility to seek license or advisory opinion from state bodies that would enable them to administer URM-related cases.

[E] Constitution of the Arbitral Tribunal

The constitution of the arbitral tribunal may also present difficulties in SDN-related cases. Some arbitrators may hesitate to receive nominations from SDNs, especially if an arbitrator’s country imposed URM on an SDN. For the same reason, an agreed chairperson may also refuse to act. That may limit the pool of suitable candidates and slow down the process. The situation may aggravate if the applicable substantive law is the law of the sanctioning state, but suitable candidates from that state would not agree to accept a nomination from the SDN. In that situation, it is hard to ensure that the parties will be on an equal footing in the arbitration.

The 2016 RAA Sanctions Survey revealed that arbitrators were generally ready to accept nominations from the SDNs. The results included answers from ninety-nine arbitrators, sixty-two of whom originated from the states which levied URM against Russian companies, and thirty-seven originated from other nations.

The survey revealed that if the seat of arbitration was in the sanctioning state, seventy-seven arbitrators would accept a nomination as arbitrator from an SDN. Only eight arbitrators would refuse and fifteen did not answer. To sum up, 77% of all interviewed arbitrators would accept a nomination from an SDN if the seat of arbitration was in the sanctioning state.

However, if the seat of arbitration *was outside* the sanctioning state, seventy-two arbitrators would accept a nomination as arbitrator from an SDN. Only seven arbitrators would refuse and twenty-one did not reply. To sum up, 72% of all interviewed

21. See, Article 41 of the ICC Rules of Arbitration (2021); Article 31 of the LCIA Arbitration Rules (2020); Article 52 of the SCC Arbitration Rules (2017).

arbitrators would take a nomination from an SDN if the seat of arbitration *was not* in the sanctioning state.

Although the results of the 2016 RAA Sanctions Survey give some hope, the constitution of the arbitral tribunal may present difficulties in practice. As a practical consideration, parties may avoid choosing the law of a state which has imposed URM as the substantive law of a contract. Similarly, parties may want to avoid selecting a seat of arbitration in a sanctioning state or a state which may potentially impose URM in the future.

[F] The Effect of URM on Commercial Contracts

An arbitral tribunal which considers an SDN-related case may expect to be asked to rule on the issues of public policy, force majeure, hardship, changed circumstances, validity, and enforceability of a commercial contract affected by URM.

Although some of these issues may be agreed in the contract, many other issues depend on the applicable substantive law and its imperative norms. Therefore, the contents of the imperative norms shall be borne in mind when drafting a contract and arbitration clause. One of such norms to bear in mind is Article 11 of the Council Regulation (EU) No. 833/2014 of July 31, 2014, concerning restrictive measures in view of Russia's actions destabilizing the situation in Ukraine, which reads as follows:

1. No claims in connection with any contract or transaction the performance of which has been affected, directly or indirectly, in whole or in part, by the measures imposed under this Regulation, including claims for indemnity or any other claim of this type, such as a claim for compensation or a claim under a guarantee, notably a claim for extension or payment of a bond, guarantee or indemnity, particularly a financial guarantee or financial indemnity, of whatever form, shall be satisfied, if they are made by:

- (a) entities referred to in points (b) or (c) of Article 5, or listed in Annex III;
- (b) any other Russian person, entity or body;
- (c) any person, entity or body acting through or on behalf of one of the persons, entities or bodies referred to in points (a) or (b) of this paragraph.

Despite the passive voice employed by Article 11 ("no claims shall be satisfied"), one may interpret the language as prohibiting all EU-based AIs and arbitrators to satisfy any claims brought by or on behalf of an SDN and even broader—by "any other Russian person, entity or body." Eventually, Article 11 of the EU Regulation harms both—SDN users and European providers of arbitration services.

Given the difficulties that a national applicable law may entail (e.g., preventing an SDN from instructing legal representatives, experts and service providers, nomination of arbitrators), parties may consider choosing the applicable law of a state which has not imposed and will unlikely impose URM in the future. Alternatively, parties may

fully exclude the application of national laws and rediscover *lex mercatoria* as an autonomous legal system. It could be the UNIDROIT Principles of International Commercial Contracts, or sets of other delocalized legal norms (FIDIC, INCOTERMS, etc.).

[G] Setting Aside and Recognition and Enforcement of Arbitral Awards

Validity and enforceability of an arbitral award are the final stop before collecting the debt. A state judge has to decide, *ex officio*, whether the arbitral award complies with the “public policy” of a particular state, and more precisely with its URM-related restrictions. A lot has been said about public policy, but the following quotes describe it in the most concise yet comprehensive manner:

Public policy does not admit of definition and is not easily explained. It is a variable quantity; it must vary and does vary with the habits, capacities, and opportunities of the public.²²

It is impossible to say what the opinion of a man or a Judge might be as to what public policy is.²³

Public policy is a very unruly horse, and when once you get astride it you never know where it will carry you.²⁴

Indeed, it is impossible to say what the opinion of a judge might be as to what public policy is, especially when dealing with URM. After all, it may be less important because in the current circumstances, only a few SDNs may successfully reach the stage of recognition and enforcement of arbitral awards.

§8.07 A WAY FORWARD

An average SDN, be it a Russian, Chinese, or other, is often a company which trades internationally. It is well established that arbitration has become a preferred method for the resolution of international business disputes. Although there is no doubt that it will remain the same, the question is whether institutional arbitration will be able to adapt to the changing circumstances, such as rapid expansion of national URM programs. If not, there is a prospect that a fast-growing global club of SDNs will lean more toward *ad hoc* arbitration.

A possible way forward would be to exclude arbitration from the scope of URM. It is in the best interest of AIs to lead the discussion and promote a URM free arbitration to: (a) guarantee access to justice as a basic principle of the rule of law; and (b) meet AIs’ own contractual obligations under the arbitration rules.

22. Kekewich, J., *Davies v. Davies* (1887), L. R. 36 C. D. 364; see also *Egerton v. Earl Brownlow*, 4 H. L. C. 1.

23. Jessel, M.R., *Besant v. Wood* (1879), L. R. 12 C. D. 620.

24. Burrough, J., *Richardson v. Mellish* (1824), 2 Bing. 252; quoted by Lord Bramwell in *Mogul Steamship Co.; McGregor, Gow and others*, 66 L. T. Rep. 6.

It is time to recall that international arbitration is a delocalized system with a large degree of contractual procedural freedom. AIs' and tribunals' mandates are not based on national laws or on ever-changing political preferences, but they are based on parties' consent to arbitrate. Users of arbitration have made their conscious choice. It is a turning point for AIs to prove that the choice is correct.