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THE EFFECTS OF SANCTIONS ON INTERNATIONAL ARBITRATION

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Abstract

Sanctions have become ubiquitous in recent years as an increasingly important tool in international relations. Economic sanctions allow states and international organisations to apply 'soft' pressure to regulate the behaviour of state actors, and are perceived to be less risky, less costly and more socially acceptable than military action. Sanctions also represent a means to give effect to policy goals informed by the resurgence of nationalism and protectionist trade policies.

During the COVID-19 pandemic, sanctions regimes have remained in place and, in some cases, have even been expanded. The combined economic pressure of sanctions and the pandemic has in some cases contributed to target countries experiencing significant financial troubles, and has sparked a debate about whether sanctions are overreaching their original purpose.

Sanctions affect international trade and sanctions issues are therefore more likely to arise in the context of disputes ensuing from cross-border transactions,

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* The views expressed in this paper are the authors' own and do not represent the views of other members of their organizations. With thanks to the contribution of Matthew Fisher.

which are typically referred to arbitration. International arbitration practitioners should therefore become familiar with the various legal issues that are likely to arise in disputes where one of the parties becomes subject to sanctions.
In this paper we: (i) introduce and define the concept of sanctions; (ii) consider the effects of sanctions on arbitration, including vis-à-vis the parties, the arbitral tribunal and the institution administering the proceedings; and (iii) explore certain strategies that may help arbitration users to mitigate the effects of sanctions on contracts. While we consider various legal systems when addressing these issues, this paper is principally focused on English and Italian law.

1. *Introduction.* — 'Sanctions' is a broad notion that encompasses a variety of different measures that can be brought by international institutions and individual states [1]. Here the term is used narrowly to refer to legislation brought into effect by states or international bodies to regulate the behaviour of targeted countries and their nationals [2].

International arbitration users are most likely to encounter sanctions imposed by the EU, the UN and the U.S. (the most prolific creators of sanctions) with respect to Russia [3], Iran [4] or Venezuela [5] (the most commercially significant targets of sanctions). These sanctions generally

[1] This paper was drafted during the Trump administration. New legislative measures might have been enacted before its publication. For example, President Biden announced that the U.S. will withdraw President Trump's restoration of UN sanctions on Iran and may rejoin the 2015 nuclear agreement.

[2] The European Union refers to sanctions as "restrictive measures" on the basis that they are not intended to be punitive and are intended to bring about a change in policy or activity of the non-EU country responsible for the undesirable behaviour (*see, e.g.* https://ec.europa.eu/info/business-economy-euro/banking-and-finance/international-relations/restrictive-measures-sanctions_en#:~:text=Restrictive%20measures%20%28sanctions%29%20are%20an%20essential%20tool%20in,name%20%E2%80%98sanctions%E2%80%99%2C%20EU%20restrictive%20measures%20are%20not%20punitive). A public debate around the repercussions of sanctions, particularly their humanitarian impact, can be observed in countries such as Cuba, Venezuela, Iran and Syria, which are targeted by coercive measures imposed by various countries. In the case of Venezuela, some in the U.S. Congress have called for a suspension of U.S. sanctions during the COVID-19 pandemic: https://fas.org/sgp/crs/row/IF10715.pdf. *See also* N. Torsello - M. Winkler, *Coronavirus-infected international business transactions: a preliminary diagnosis*, in *Dir. comm. internaz.*, 2020, 847. *See*, *e.g.*, the US Caesar Syria Civilian Protection Act of 2019, which took effect on 17 June 2020.

[3] The U.S. has issued several rounds of sanctions against Russia for its intervention in Crimea and its alleged invasion of Ukraine, electoral interference, cyber activities, human rights violations, chemical weapons use, weapons proliferation, trade with North Korea, and support to Syria and Venezuela. Recently, the Protecting Europe's Energy Security Act of 2019 was introduced to provide sanctions for foreigners who have since December 2019 sold, leased or supplied undersea pipelayers for the construction of the Russian Nord Stream 2 and TurkStream pipelines, or any subsequent pipeline. The company that laid the pipeline has suspended its activities. The world's largest group of marine insurers (The International Group

take the form of asset/dealing restrictions, transaction-based restrictions, travel restrictions or comprehensive restrictions:

• Asset and dealing restrictions. Both the EU (in the form of general sanctions) and the U.S. (in the form of specially designated national, or SDN, sanctions) have sanctions in place that prohibit dealing with targeted persons [6]. These dealing restrictions typically freeze the assets of the targeted persons by requiring banks to block such persons' access to their financial accounts and prohibiting persons within the jurisdiction from providing funds or other things of value to sanctioned persons. Companies controlled 50% or more by such persons are subject to the same restrictions.

• Transaction-based restrictions. These include (*a*) export controls and (*b*) sectoral sanctions. Export controls restrict export of items into the target jurisdiction to prevent the target country from carrying out certain activities. While military goods or "dual-use" goods with both

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of P&I Clubs, representing about 90% of marine insurers) declared on 21 September 2020 that it will not insure the ships involved in the targeted pipeline projects.

[4] Since the 1979 Islamic Revolution, U.S. policy towards Iran has largely been implemented by way of economic sanctions. The UN and EU have also imposed sanctions in response to the IRI nuclear program. In 2015, Iran entered into an agreement that put limits on its nuclear program - the Joint Comprehensive Plan of Action (or JCPOA). On 8 May 2018, the U.S. announced that it would no longer participate in the JCPOA, and had reimposed all secondary sanctions by 6 November 2018. In March 2020, considering the COVID-19 situation in Iran, the U.S. revised public sanctions guidance to prompt foreign companies to proceed with sales of humanitarian items and offered assistance to help Iran. Iran has refused such assistance, but it has applied to the International Monetary Fund (IMF) for aid.

[5] For more than a decade, the U.S. has imposed sanctions in response to the activities of Venezuela, the Venezuelan government and various Venezuelan nationals. The Department of Treasury imposed sanctions on 150 Venezuelans persons and four shipping companies involved in the transport of Venezuelan oil, along with two subsidiaries of Rosneft Oil Company (controlled by the Russian state) because they were allegedly facilitating Venezuelan oil exports. The State Department has revoked visas from more than 1,000 Venezuelan nationals and their families. In addition, the Trump administration has also imposed sanctions against the Venezuelan state oil company (Petróleos de Venezuela, S.A.), as well as the government and central bank. On 20 August 2020, the Treasury imposed a system of economic sanctions on a further 100 Venezuelans. This comes in addition to the asset freezes put in place by the Obama Administration, which were recently expanded to cover an additional 91 Venezuelan officials, including President Maduro, his wife, and son; the Vice President; the Socialist Party President; the judges of the Supreme Court; the leaders of the army, national guard and police; certain governors; the director of the central bank; and the foreign minister. On 7 May.2019, the Treasury lifted sanctions against the former head of the Venezuelan secret service.

[6] The list of such persons in the EU subject to such sanctions can be found online at: https://urldefense.proofpoint.com/v2/url?u=https-3A__webgate.ec.europa.eu_europeaid_fsd_fsf_public_files__pdfFullSanctionsList_content-3Ftoken-3Dn001zz52&d=DwMCaQ&c=6ldJ3EG4a4nVimLYnfpfYA&r=n971GOvqgHJ8w97YJG-LNQ&m=Xqx-yr0PuLICl70VyirGxNk3W2V_8TIuTuC91gY-JWg&s=dhqWhKcBLfXYxGKj1fLjz0iQqWynbSZCLZMBa34kan8&e.

civilian and military uses are usual targets, civilian goods related to sanctioned activities may also be targeted. For example, certain EU and U.S. sanctions target export of goods into Russia for the purpose of deep-water drilling, Arctic drilling and hydraulic fracturing of shale [7]. Sectoral sanctions prevent transactions with persons active in a particular sector of the economy of the target country. For example, the sectoral sanctions regime in force in the EU and the U.S. prohibits financing of entities within the Russian energy and financial sectors.

• Travel restrictions. These include flight and visa bans, often used in "smart" sanctions programmes where specific persons are targeted.

• Comprehensive restrictions. These are the most expansive form of sanctions and aim to create something close to an embargo on a particular territory by prohibiting virtually all dealing with the targeted jurisdiction and persons located, organised, or resident in that jurisdiction [8].

Sanctions can also come in the form of 'primary' or 'secondary' sanctions. Primary sanctions legislation is drafted to prevent persons *within* the territorial or personal jurisdiction of the sanctioning country from engaging in key targeted activities. Secondary sanctions are designed to negatively affect persons *outside* the territorial or personal jurisdiction of the sanctioning country engaging in targeted activities, including, for example, by restricting their ability to do business with financial institutions within the territorial or personal jurisdiction of the sanctioning country [9].

2. *Effects of Sanctions on Arbitration.* — International arbitration users may encounter sanctions at different points in the life cycle of an arbitration. Sanctions-related questions that typically arise in arbitration include one or more of the following: are disputes concerning sanctions arbitrable? Does supervening illegality or a force majeure event excuse non-performance of an ongoing contract by a party that becomes subject to sanctions? How is an arbitral institution likely to approach disputes involving the application of sanctions legislation? Would it accept a reference if the dispute involves an entity subject to sanctions? What

[7] EU Regulation 833/2014 dated 31 July 2014.

[8] While the EU Crimea sanctions come close to being comprehensive, only the U.S. has introduced true comprehensive sanctions - against Cuba, Crimea, Iran, North Korea, and Syria.

[9] *See, e.g.* Iranian Transactions & Sanctions Regulations.

issues is an arbitrator likely to consider before deciding whether to accept an appointment in arbitration proceedings where one of the parties is subject to sanctions?

We consider these and related issues below [10].

2.1. *The Impact of Sanctions on Arbitrating Parties.* — Here we consider the threshold question of whether a dispute concerning the application of sanctions is arbitrable. We then consider the substantive arguments that parties may seek to invoke in arbitration proceedings where sanctions are at play.

2.1.1. *Arbitrability.* — As a general matter, 'arbitrability' concerns the question of whether a particular dispute is capable of settlement by arbitration. As the authors of a leading treatise on international arbitration put it:

> "*Arbitrability [...] involves determining which types of dispute may be resolved by arbitration and which belong exclusively to the domain of the courts. [...] [I]t is precisely because arbitration is a private proceeding with public consequences that some types of dispute are reserved for national courts, the proceedings of which are generally in the public domain. It is in this sense that they are not 'capable of settlement by arbitration'. National laws establish the domain of arbitration as opposed to that of the local courts. Each state decides which matters may or may not be resolved by arbitration in accordance with its own political, social, and economic policy*" [11].

In light of the public policy issues underlying the adoption and enforcement of sanctions, the party facing a defence that contractual non-performance should be excused on the basis that the non-performing party is subject to sanctions may argue that the dispute is not capable of settlement by arbitration. That issue would have to be addressed on the basis of the law governing the arbitrability of the dispute.

As a general matter, issues of arbitrability are determined by refer-

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[10] For a contribution on the legitimacy of arbitral institutions in the era of trade wars, *see* E. Park, *International Arbitration in the Era of Trade Wars and Nationalism*, in *Int. Constr. Law Rev.*, 2020, Vol. 37, 2020.

[11] N. Blackaby, C. Partasides, *et al.*, *Redfern and Hunter on International Arbitration (Sixth Edition)*, 2015, p. 80 ff.. Disputes which have traditionally given rise to issues of arbitrability include disputes involving patents, trademarks and copyright, antitrust and competition law issues, insolvency, and bribery and corruption.

ence to the law governing the arbitration agreement. Absent a specific choice of law clause applicable to the arbitration agreement, national courts and arbitral tribunals have identified such law by reference to either the law of the seat of the arbitration (curial law or *lex arbitri*) [12] or the applicable substantive law (the law governing the contract out of which the dispute arises or *lex causae*) [13]. However, if a question on the

[12] This is the approach traditionally followed by most civil law courts, including Italy, Belgium, the Netherlands and Sweden. *See*, *e.g.*: (i) Court of Appeal of Florence, judgment of January 30, 2006; Court of Appeal of Genoa, judgment of February 3, 1990; Italian Supreme Court, December 15, 1982, judgment No. 6915; Italian Supreme Court (Grand Chamber), January 28, 1982, judgment No. 563; Italian Supreme Court (Grand Chamber), April 15, 1980, judgment No. 2448, in F. Emanuele, M. Molfa, *et al.*, *Selected Issued in International Arbitration: The Italian Perspective*, 2014, p. 49 ff.; (ii) Matermaco SA v. PPM Cranes Inc., Legris Industries SA, Tribunal de Commerce, judgment of September 20, 1999, in YBCA, 2000, Vol. XXV, p. 673 ff.; (iii) Owerri Commercial Inc. v. Dielle Sri, Gerechtshof, The Hague, judgment of August 4, 1993, in J.D.M. Lew, L.A. Mistelis, S.M. Kröll, *Comparative Commercial Arbitration*, 2003, p. 121; and (iv) Bulgarian Foreign Trade Bank Ltd. v. A.I. Trade Finance Inc., Swedish Supreme Court, T 1881-99, judgment of October 27, 2000, in YBCA, 2001, Vol. XXVI, p. 291 ff. This approach is consistent with Article V.1(a) of the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "New York Convention"), pursuant to which "[r]ecognition or enforcement of the award may be refused" if the arbitration agreement "is not valid under the law to which the parties have subjected it or, failing any indication thereon, *under the law of the country where the award was made.*" The "law of the country where the award was made" is presumed to be the law of the seat of the arbitration. *See* Articles 31(3) and 20(1) of the Model Law. *See also*, *e.g.*, section 53 of the English Arbitration Act; Article 823, second paragraph, No. 2 of the Italian Code of Civil Procedure; section 31, second paragraph, of the Swedish Arbitration Act (2019); section 38(4) of the Singapore Arbitration Act.

[13] This is the approach followed by certain common law courts, including — until very recently — the English courts. Absent indication to the contrary, English courts would normally infer the law governing the arbitration agreement based on the choice of law clause applicable to the main contract. As stated by the Court of Appeal in *Sulamérica*, "[i]t has long been recognised that in principle the proper law of an arbitration agreement which itself forms part of a substantive contract may differ from that of the contract as a whole, but it is probably fair to start from the assumption that, in the absence of any indication to the contrary, the parties intended the whole of their relationship to be governed by the same system of law. It is common for parties to make an express choice of law to govern their contract, but unusual for them to make an express choice of the law to govern any arbitration agreement contained within it; and where they have not done so, *the natural inference is that they intended the proper law chosen to govern the substantive contract also to govern the agreement to arbitrate.*" Sulamérica Cia Nacional de Seguros S.A. and others v. Enesa Engenharia S.A. and others [2012] EWCA Civ 638, paragraphs 11 and 26 (emphasis added). In a judgment issued on April 29, 2020, however, the Court of Appeal held that, absent "powerful countervailing factors," *there is a "strong presumption that the parties have impliedly chosen the curial law as the AA law [i.e., the law governing the arbitration agreement].*" Enka Insaat ve Sanayi AS v OOO Insurance Company Chubb *et al.* [2020] EWCA Civ 574 (emphasis added). It is in this respect interesting to note that in the 2014 LCIA Rules, which postdate *Sulamerica*, the LCIA adopted a position more aligned with the 2020 judgment in *Enka.* In relevant part, Article 16.4 of the LCIA Rules provides that "The law applicable to the Arbitration Agreement and the arbitration *shall be the*

arbitrability of the dispute arises in state court proceedings at the pre-award stage, the court seised of an action in respect of which there exists an arbitration agreement is also likely to look at its own law (*lex fori*) [14]. The same holds true if the issue of arbitrability is raised at the stage of recognition and enforcement of the arbitral award [15].

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law applicable at the seat of the arbitration, unless and to the extent that the parties have agreed in writing on the application of other laws or rules of law." The *Enka* default rule was therefore already applicable in spite of *Sulamerica* to those arbitrating their disputes under the LCIA Rules. In other words, *Enka* somehow cured the inconsistency in the approach between English law post-*Sulamerica* and the 2014 LCIA Rules in furtherance of certainty. Other common law courts that have looked at the *lex arbitri* to determine to law governing the arbitration agreement absent a specific choice of law clause applicable to it include Australia, Hong Kong and India. *See*, *e.g.* (i) Recyclers of Australia Pty Ltd v. Hettinger Equip. Inc. (2000) 175 A.L.R. 725 (Australian Fed. Ct.) (applying Iowa law, in accordance with the choice-of-law clause included in the main contract, to questions of substantive validity of arbitration clause); (ii) Beyond the Network Ltd v. Vectone Ltd [2005] HKEC 2075; and (iii) Nat'l Thermal Power Corp. v. The Singer Co., in YBCA, 1993, Vol. XVIII, pp. 403, 406-407 (S.Ct. of India 1992) ("where the proper law of the contract is expressly chosen by the parties, as in the present case, such law must, in the absence of an unmistakable intention to the contrary, govern the arbitration agreement which, though collateral or ancillary to the main contract, is nevertheless a part of such contract"), in G.B. Born, *International Commercial Arbitration*, 2009, p. 445.

[14] Pursuant to Article II of the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Award (the "New York Convention"), Contracting States have the public international law obligation to recognize international arbitration agreements that satisfy the 'in writing' requirement set forth in Article II.2 of the New York Convention, provided that (i) the dispute concerns "a subject matter capable of settlement by arbitration" and (ii) the court seized of an action in respect of which there exists an arbitration agreement does not find that agreement to be "null and void, inoperative or incapable of being performed". Since issues of arbitrability typically raise issues of public policy under municipal law, it is understandable that the national court seized of an action in respect of which there exists an arbitration agreement would normally look at its own law to determine whether the dispute before it is arbitrable. Thus, in a dispute arising out of contracts for the procurement of naval ships to Iraq where the arbitration agreements provided for ICC arbitration seated in Paris, an Italian Court of Appeal found, pursuant to Article II.1 of the New York Convention and the Italian *lex fori*, that the dispute had become incapable of settlement by arbitration following the UN embargo imposed against Iraq in connection with the 1990 invasion of Kuwait. As held by the Court: "The answer [as to the arbitrability of the dispute] must be found in Italian law, according to the legal principle that, when the validity of a foreign arbitration agreement is challenged before a state court, the arbitrability of the dispute must be determined in light of the *lex fori* because this question directly affects that state court's jurisdiction to adjudicate the dispute; this approach is consistent with Articles II and V New York Convention [...]." Court of Appeal of Genoa, judgment No. 506 of May 7, 1994. *See also* Italian Supreme Court, August 8, 1990, judgment No. 7995, holding that "issues of arbitrability of the dispute resolved by the foreign arbitral tribunal must be determined in light of the *lex fori.*" *See* J.D.M. Lew, L. Mistelis, *et al.*, *Comparative International Commercial Arbitration*, Kluwer 2003, para. 9-13 ("in the majority of cases courts have determined the question of arbitrability at the pre-award stage according to their own national law.").

[15] *See*, *e.g.*, Article V.2 of the New York Convention, providing in relevant part that "[r]ecognition and enforcement of an arbitral award may also be refused if the competent

There are therefore multiple stages at which effect of sanctions on the arbitrability of a dispute might arise, each of which raises specific conflict of law issues: the dispute before the tribunal itself; when one or more national courts are seised of an action in respect of which there exists an arbitration agreement; at the post-award stage, in set-aside or recognition and enforcement proceedings. Any ruling by an arbitral tribunal that a sanctions dispute is arbitrable will not be binding on the national courts dealing with the same issue. Moreover, since the tribunal's award on the issue of arbitrability is likely to be characterised as jurisdictional in nature, a challenge of that award before the court at the arbitral seat would likely result in a full, *de novo* review of the underlying jurisdictional issue [16].

There seems to be consensus among international arbitration scholars that disputes involving sanctions issues remain arbitrable [17]. National courts in both common law and civil jurisdictions have also generally upheld that view. For example:

(i) In *Belship Navigation Inc v Sealift Inc*, the U.S. District Court for the Southern District of New York granted a motion to compel arbitration of a dispute involving the Cuban Assets Control Regulations [18].

(ii) In *Air France v. Libyan Airlines*, the Quebec Court of Appeal agreed with the Montreal-seated tribunal's decision and found that UN sanctions against Libya were not a barrier to arbitrability of the dispute [19].

(iii) In *Fincantieri-Cantieri Navali v. Ministry of Defense of Iraq*, the Swiss courts found that the provisions of the Swiss Private International Law Act did not mean that the arbitrability of the dispute violated Swiss public policy [20].

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authority in the country where recognition and enforcement is sought finds that [...] The subject matter of the difference *is not capable of settlement by arbitration under the law of that country* [...]." (emphasis added).

[16] This would be the position in England under section 67 of the Arbitration Act 1996.

[17] M.A. Da Silveira, *Chapter 7: Economic Sanctions, Force Majeure and Hardship*, in F. Bortolotti and D. Ufot (eds), *Hardship and Force Majeure in International Commercial Contracts: Dealing with Unforeseen Events in a Changing World*, *Dossiers of the ICC Institute of World Business Law, Volume 17*, Kluwer, 2018, p. 162.

[18] 95 Civ 2748 (RPP).

[19] Air France v Libyan Airlines, Cour d'appel du Québec, 31 March 2003, (2003).

[20] *Fincantieri-Cantieri Navali v. Ministry of Defense of Iraq*, Tribunal fédéral suisse (1re Cour civile), Judgment of 23 June 1992, *Revue de l'arbitrage*, 691 (1993).

In certain jurisdictions like Italy, however, courts have made a series of findings that disputes affected by UN and EU sanctions are in fact *not* arbitrable. For example, in a seminal 2015 judgment the Italian Supreme Court found that a dispute regarding a contract for the procurement of helicopters between an Italian company and the Iraqi government and Ministry of Defence affected by UN and EU sanctions was not arbitrable and the underlying arbitration clause was null and void [21]. The Court held that the parties could not arbitrate in respect of mandatory provisions of law, employing the same reasoning applied in an earlier ruling in the *Fincantieri* case in the Court of Appeal of Genoa [22].

Thus, while the majority view appears to be that a private dispute involving the application of sanctions and the consequences they might have on an ongoing contract remains arbitrable, there are decisions going the other way. It is therefore important to pay particular attention to the dispute resolution mechanism when entering into long-term contracts with entities that risk being sanctioned. In such cases, the dispute resolution mechanism should be designed to insulate the parties as far as possible from the uncertainty that would be caused by a local court deeming the contract non-arbitrable.

2.1.2. *Illegality Clauses.* — Parties affected by sanctions may seek to avoid complying with their obligations under a contract by relying on an illegality clause which excuses non-performance where performance would cause that party to commit an illegal act.

The key question, of course, is through what lens one views illegality. What is illegal in one country may be legal in another. What is or is not legal in the context of a particular contract will depend on the relevant governing law(s) and the way the illegality clause is phrased. For instance, that a given act would be illegal if carried out in jurisdiction X is typically irrelevant to determining whether such act is also illegal in jurisdiction Y — what matters is what the laws of jurisdiction Y say about the act in question. Applying this to sanctions, an English or Italian company has no legal obligation under English or Italian law (for example) to observe U.S. sanctions, meaning that there is no illegal

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[21] *Government and Ministries of the Republic of Iraq v. Armamenti e Aerospazio S.p.A. et al.*, Italian Supreme Court, 24 November 2015, judgment No. 23893.

[22] *Fincantieri - Cantieri Navali Italiani S.p.A. & Oto Melara S.p.A. v. Ministry of Defence*, No. 138, Corte di Appello, Genoa, Judgment, 7 May 1994.

breach of U.S. sanctions if the company continues to deal with a sanctioned person, even if such dealings would be a breach of U.S. sanctions law if carried out by a person required to comply with U.S. law. Typically, therefore, there is no illegal act that would provide grounds for a party to invoke an illegality clause in the contract. For this reason, illegality clauses are of limited relevance as the mere fact of a party being added to a list of sanctioned entities does not entail any illegal act.

One must be careful, however, of exceptions to that general rule. To take one example, while the default English common law position is that, where England is the place of performance, an illegality clause in an English-law governed agreement may not be invoked by reference to a breach of foreign law, recent case law has shown that this position may be displaced where the contract, for example, refers to a breach of regulations without reference to any jurisdictional limitation [23].

In addition, not every dealing with a sanctioned person is a breach of sanctions (particularly in the case of secondary sanctions). Again, this needs to be taken with a grain of salt as there may be specific jurisdictional overlays to this general principle, which mean illegality assumes an unexpectedly broad meaning. For example, in the *LIL v CBL* case, the English Court of Appeal has recently confirmed that it is possible for illegality clauses to be engaged by secondary sanctions [24]. There the Court excused CBL's non-payment to LIL under an English-law governed, Sterling-denominated loan agreement purportedly affected by U.S. secondary sanctions. The agreement provided that CBL was entitled to refuse repayment of the loan to the extent that refusal was necessary "to comply with *any mandatory provision of law*, regulation or order of any court of competent jurisdiction". The court took particular notice of the fact that the parties drafting the clause would have been familiar with the EU Blocking Regulation, which describes U.S. secondary sanctions as a "requirement or prohibition" with which EU parties must "comply". In these circumstances, the reference to a "mandatory provision of law" was interpreted as extending beyond merely a prohibition that prevents the borrower from paying to also cover the risk of falling subject to U.S. secondary sanctions.

[23] *National Bank of Kazakhstan and another v. Bank of New York Mellon*, [2018] EWCA Civ 1390.

[24] *Lamesa Investments Limited v Cynergy Bank Limited* [2020] EWCA Civ 821; confirming the High Court decision in *Lamesa Investments v. Cynergy Bank* [2019] EWHC 1877.

2.1.3. *Force Majeure Clauses.* — The concept of force majeure applies, broadly speaking, where unforeseeable circumstances beyond the control of the parties prevent performance of a contract. Where it applies, non-performance will be excused and not treated as a breach of contract, either permanently or temporarily.

The concept of force majeure varies from jurisdiction to jurisdiction. In some jurisdictions, particularly civil law jurisdictions such as Italy, force majeure is a general legal principle provided for in the civil code. There is a line of authorities in Italian case law holding that the existence of regulatory measures limiting or excluding the possibility of fulfilling obligations targeted by international sanctions constitutes grounds to argue that the obligations are impossible to fulfil, giving rise to the extinction or a declaration of non-existence of the relevant obligation [25]. In particular, the Italian Supreme Court upheld a declaration of extinction of a bank's obligation in respect of a letter of credit issued in favor of an Italian entity for the purposes of the Italian entity's performance of a contract with an Iraqi entity because the underlying contract could no longer be performed due to the embargo [26].

[25] Court of Genova, judgment dated 9 December 1992, Soc. Fincantieri e altro c. Gov. Rep. Iraq. *See also* Court of Padova, judgment dated 1 October 1993, in *Banca Borsa Tit. cred.*, 1993, II, 163; Court of Genova, judgment dated 11 July 1996, Soc. Fincantieri e altro c. Rep. Iraq e altro, *Danno e resp.* 1997, p. 217, with a commentary by Lazari ("it is indisputable that the wrongful conduct of the Iraqi State [subject to embargo] has directly resulted in an immediate event (the embargo measures); that event has, in turn, caused the services subject matter of the underlying contract impossible to perform, such that the Iraqi State must be held responsible in respect of the latter event, which is causally linked to the wrongful conduct of the Iraqi State. The contracts must therefore be declared terminated due to impossibility of performance attributable by the relevant Iraqi party, which must therefore be held liable for damages."); Court of Udine, judgment dated 13 July 1998, Soc. Danieli c. Soc. State Enterprise for Iron and Steel and others, in *N. giur. civ. comm.* 1999, I, p. 201, with a commentary by Rolli ("Based on the rules applicable to the impossibility to perform a contract due to an act attributable to the party entitled to receive performance [...] pursuant to art. 1207 of the Civil Code, as well as the general obligation of good faith in the performance of a contract, the creditor to whom the impossibility to perform a contract is attributable is liable to perform its own obligation and to compensate the other party of the damages it has suffered. The contract must therefore be terminated and the party that has made performance impossible held liable for damages towards the other party.").

[26] Italian Supreme Court, 29 January 2003, judgement No. 1288. *See* F. Marrella, *Embargo irakeno e compromettibilità in arbitri delle controversie* (Note to T. Busto Arsizio, 27 October 2003, Soc. Agusta c. Gov. Iraq), in *N. giur. civ.*, 2004, I, 396. *See also* B. Inzitari, *Inesigibilità della prestazione, impossibilità della prestazione per l'embargo contro l'Iraq*, in *N. giur. civ.*, 1995, II, 48; C. M., Lo Savio, *Embargo e lettere di credito*, in *Riv. dir. intern.*, 1996, 685; R. Rolli, *« Guerra del Golfo » ed embargo internazionale: la sopravvenuta impossibilità della prestazione imputabile al creditore*, in *Contr. impr.*, 1997, p. 115.

In other jurisdictions, particularly common law jurisdictions such as England, there is no such general legal principle of 'force majeure' (although see the discussion on frustration below), but the parties may make contractual provisions to allocate risk between them in force majeure circumstances [27].

In most common law jurisdictions, therefore, the question of the impact of force majeure is one of contractual interpretation. Whether a force majeure clause may in fact be relied upon in the face of sanctions will depend on the exact wording thereof. Disputes may focus on wording that requires the events in question to "prevent" performance. This is a high threshold and one that would not be necessarily triggered by the imposition of sanctions on a counterparty. After all, while sanctions may make dealing with one's counterparty undesirable and risky [28], they may not actually prevent one from doing so.

Where dealing with one's counterparty would expose one to secondary sanctions (i.e., the threat of being sanctioned by becoming unable to access U.S. banking facilities), it is likely to be even more difficult to rely on a force majeure clause. For example, the English courts have previously ruled that the mere announcement of future restrictions affecting dealings of the type provided for in a given contract is insufficient to engage a force-majeure-type clause [29]:

> "*it could not be said [...] when sellers purported to declare the contract cancelled, that there was a prohibition restricting [performance of the contract]. [T]here was at the time a prohibition which might or might not do so.*"

2.1.4. *The Doctrine of Frustration.* — In the absence of any explicit contractual grounds to excuse non-performance of its obligations under a contract that has been tainted by sanctions, under the laws of certain common law jurisdictions a party may seek to invoke the doctrine of frustration.

Frustration can act to excuse non-performance or render suits for non-performance unenforceable. When successfully invoked, the doc-

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[27] Note that if a force majeure clause in an English-law contract fully provides for the effect that the imposition of sanctions will have on the rights and obligations of both parties, the effect will be to prevent the doctrine of frustration from operating.

[28] But not always. English courts have in some cases found embargoes or similar restrictions to "prevent" the performance of a contract: Tradax Export SA v André et Cie [1976] 1 Lloyd's Rep. 416, for example.

[29] Bunge SA v Nidera B.V. [2013] EWHC 84 (Comm).

trine of frustration generally acts to terminate a contract and discharge the parties from liability thereunder. The scope of the doctrine will depend on the jurisdiction in question, and may (as in the case of England) be poorly defined or subject to varying judicial interpretations.

Nonetheless, frustrating events are likely to include: (i) supervening impossibility, by, for example (*a*) total and, in some extreme cases, partial destruction of the subject-matter, (*b*) unavailability of the subject matter, (*c*) destruction or unavailability of a thing (but not the subject matter) which is essential to performance and (*d*) failure of a particular source; and (ii) frustration of purpose/cancellation of an expected event.

The degree to which the doctrine is restrictively interpreted is also relevant. For the English courts, for example, the threshold for its application is particularly high — performance merely becoming impractical, onerous or uneconomic is not a recognised grounds of frustration in English law [30].

Whether sanctions frustrate a contract will depend on the specific facts. However, the following factors are likely to inform a court's decision:

— whether the imposition of sanctions "significantly changes" the nature of the obligations (a factor increasing the likelihood of frustration);

— whether the parties have already made express provision in the contract for unexpected events that may interfere with its performance [31] (a factor decreasing the likelihood of frustration); and

— the extent to which the sanctions were reasonably foreseeable [32] (a factor decreasing the likelihood of frustration).

2.1.5. *Frustration by Illegality.* — Frustration by supervening illegality is a specific subset of frustration that occurs only where performance of the contract (i) has become illegal under English law as the governing law of the contract; or (ii) necessarily involves doing an act which is illegal

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[30] For example, it has been remarked that frustration is "not lightly to be invoked to relieve contracting parties of the normal consequences of imprudent commercial bargains": Pioneer Shipping Ltd v B.T.P. Tioxide Ltd (The Nema) [1982] A.C. 724, 752.

[31] Joseph Constantine S.S. Line Ltd v Imperial Smelting Corp Ltd [1942] A.C. 154, 163; Kuwait Supply Co v Oyster Marine Management (The Safeer) [1994] 1 Lloyd's Rep. 637; Bangladesh Export Import Co Ltd v Sucden Kerry SA [1995] 2 Lloyd's Rep. 1.

[32] Edwinton Commercial Corp v Tsavliris Russ (Worldwide Salvage & Towage) Ltd (The Sea Angel) [2007] EWCA Civ 547, [2007] 2 Lloyd's Rep. 517 at [104].

under the law of the place where the act is required to be done (i.e., the *lex loci solutionis*).

A contract governed by English law will not generally be frustrated on the basis that acts to be done under it have become illegal by the law of a foreign country. Instead, frustration by illegality of a foreign country will only be successfully invoked if the contract requires, by express or implied terms, the performance of an act in a country where such act is considered unlawful [33]. This is known as the rule from *Ralli Bros v Compañia Naviera Sota y Aznar* (1920) 2 KB 287, a rule which is generally understood to be a part of the English law of frustration rather than a conflicts of law rule [34].

If the principle in *Ralli Bros* is solely part of the law of frustration, then it would not be affected by EU conflicts of law rules arising from the Rome I Regulation. However, to the extent that the *Ralli Bros* principle is a conflict of law rule, it would be superseded by the Rome I Regulation. In any event, the outcome of analysis under the EU conflict of law rules is very similar. Article 9 (3) of the Rome I Regulation provides as follows:

> "Effect may be given to the overriding mandatory provisions *of the law of the country where the obligations arising out of the contract have to be or have been performed*, in so far as those overriding mandatory provisions render the performance of the contract unlawful. In considering whether to give effect to those provisions, regard shall be had to their nature and purpose and to the consequences of their application or non-application" [35].

The difference between the two rules is the discretionary language "*may*" used in the Regulation. The similarity between the rules explains why there has been no English law ruling on the correct analysis of the *Ralli Bros* principle, as such a point of law would only arise in the rare

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[33] Tamil Nadu Electricity Board v ST-CMA Electric Co Private Ltd [2007] EWHC 1713 (Comm), [2008] 1 Lloyd's Rep. 93.

[34] *Dicey, Morris & Collins on the Conflict of Laws, (15th ed.)*, 2012, paras. 32-102. Eurobank Ergasias SA v Kalliroi Navigation Company Ltd [2015] EWHC 2377 (Comm.).

[35] Recital 37 of Regulation (EC) No. 593/2008 of the Europe Parliament and of the Council of 17 June 2008 on law applicable to contractual obligations ("Rome I") provides that "Considerations of public interest justify giving the courts of the Member States the possibility, in exceptional circumstances, of applying exceptions based on public policy and overriding mandatory provisions. The concept of 'overriding mandatory provisions' should be distinguished from the expression 'provisions which cannot be derogated from by agreement' and should be construed more restrictively".

case where the law applicable to the contract is sufficiently different from English law so as to require performance even where illegal under the *lex loci solutionis.*

The effect of sanctions on an English-law governed contract will in any event have to be carefully considered in the individual circumstances of the case. Save for the exception under *Ralli Bros*, the imposition of sanctions of a third country will generally not be considered by English courts to be sufficient for contracts governed by English law to be considered frustrated due to illegality [36]. For example, the English court held in the *Bankers Trust* case that imposition of sanctions on a U.S. bank and its foreign branches would not excuse the bank from performing a transaction on the basis that it would amount to supervening illegality. The U.S. bank was nevertheless in breach of contract for failing to transfer sums to the Libyan bank at the agreed times, even though that act would have risked exposure to U.S. sanctions.

2.2. *Effect on Arbitrators and Arbitral Institutions.* — If sanctions affect parties to arbitration either before or during the dispute, the arbitrators and arbitral institutions involved must ensure that they act in compliance with the relevant sanctions regime. EU arbitral institutions are required to identify whether parties to arbitration are sanctioned (or are beneficially owned by sanctioned entities) when references to arbitration are made.

Sanctions regimes will generally not prohibit the resolution of commercial disputes or the arbitral process, even where the core of a dispute relates to sanctions issues [37]. The primary effect of sanctions on arbitrators and arbitral institutions will be the freezing of party assets, making it more difficult for funds required for the arbitral process to be transferred. In practice, these issues generally represent an administrative hurdle for arbitrators and arbitral institutions to surmount, rather than a legal issue which fundamentally disrupts the arbitral process.

Sanctions regimes which prevent arbitrators and arbitral institutions

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[36] Toprak Mahsulleri Ofisi v. Finagrain Compagnie Commerciale Agricole et Financiere S.A. [1979] 2 Lloyd's Rep. 98; Libyan Arab Foreign Bank v Bankers Trust Co [1989] Q.B. 728.

[37] *See*, *e.g.*, Ministry of Defence and Support for Armed Forces of the Islamic Republic of Iran v International Military Services Ltd [2019] EWHC 1994 (Comm), where in respect of a dispute affected by EU sanctions against Iran, it was common ground between the parties that payments could not be made between them in satisfaction of certain claims, although litigation in respect of enforcement continued in multiple jurisdictions.

from obtaining funds for arbitration will generally have the effect of asset and dealing restrictions as outlined above. Some regimes allow explicitly for the provision of legal services to be exempted from such asset and dealing restrictions [38]. However, in practice, arbitrators and arbitral institutions will likely seek from the parties formal clearances and licences from sanctioning authorities before accepting administrative payments from sanctioned entities [39]. If EU or U.S.-based sanctions are at issue, banks with branches in these regions will be very wary of monies transferred by sanctioned entities. The result will be inevitable delay to the arbitration but not complete disruption of the process.

In 2014, when the European Union and the United States implemented far-reaching economic sanctions against Russia in relation to events in Crimea, commentators expressed the concern that this would negatively affect the market for European arbitration amongst Russian and CIS-based arbitration users [40]. In 2015, in response to these concerns, the London Court of International Arbitration (LCIA), International Chamber of Commerce (ICC) and Stockholm Chamber of Commerce (SCC) released a joint article designed to assure Russian and CIS-based parties and their advisors that there was no need to reconsider designating European seats and European arbitral institutions in arbitration clauses in their contracts [41]. The article identifies certain key scenarios where sanctions might have an impact on arbitral institutions: (*a*) when a party to an arbitration is either designated by sanctions or has an ultimate beneficial owner which is designated; and (*b*) where a party to an arbitration is an entity trading in military goods. In both instances, it

[38] *See*, *e.g.*, EU Regulation 269/2014 dated 17 March 2014, which at Article 4 provides an exemption to the asset freezing provision under Article 2 as follows: "the competent authorities of the Member States may authorise the release of certain frozen funds or economic resources, or the making available of certain funds or economic resources, under such conditions as they deem appropriate, after having determined that the funds or economic resources concerned are ... intended exclusively for payment of reasonable professional fees or reimbursement of incurred expenses associated with the provision of legal services".

[39] *The potential impact of the EU sanctions against Russia on international arbitration administered by EU-based institutions*, 17 June 2015, p. 4 (https://sccinstitute.com/media/80988/legal-insight-icc_lcia_scc-on-sanctions_17-june-2015.pdf).

[40] *The Future of Commercial Arbitration with Russian Parties in the World of Sanctions*, *Who's Who Legal*, 11 December 2014 (https://whoswholegal.com/features/the-future-of-commercial-arbitration-with-russian-parties-in-the-world-of-sanctions).

[41] *The potential impact of the EU sanctions against Russia on international arbitration administered by EU-based institutions*, 17 June 2015 (https://sccinstitute.com/media/80988/legal-insight-icc_lcia_scc-on-sanctions_17-june-2015.pdf).

would have to be for the targeted party to apply for a relevant exemption from the freezing of funds by filing a request with the relevant authority.

The LCIA and ICC both outline administrative steps that will be taken in the event that parties are subject to sanctions regimes. LCIA 'Notes for Parties' state that the LCIA will always include in its initial letter to parties on the initiation of arbitration a request that the parties inform them of any issues that may prevent the parties from paying deposits when directed or participating in the arbitration, including "any restrictions, sanctions or embargoes that affect any party, whether directly or indirectly" [42]. The ICC, on the other hand, requests parties to inform the ICC that they "have reasonable doubt that a sanctions regime is applicable" in advance of paying the arbitration request filing fee to ensure that the relevant administrative steps are taken. The ICC also advises that it may call on parties to submit additional information where one of the parties or related entities is listed by a sanctions regime; the subject matter of the dispute falls within a sanctions regime; or the parties want to nominate an arbitrator from a sanctioned country [43].

There has been some discussion as to whether European arbitral institutions have been affected by a shift in perception by Russia and CIS-parties (or parties of other nationalities) that European institutions are less impartial due to the sanctions imposed by the U.S. and E.U. For their part, the institutions make clear that they are politically neutral and there is a strong expectation of impartiality among the arbitration bar in European countries. Whether there has in fact been or will be any effect on arbitral institutions in this regard depends on the difficult question of the perception of European institutions by Russian and CIS-based arbitration users. While there is some anecdotal evidence that Russian parties have moved away from European arbitral seats and institutions, there is also evidence that such a shift has not yet occurred. A 2017 survey by the Russian Arbitration Association determined that London and Stockholm remain the most favoured arbitral institutions of Russian arbitration users [44].

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[42] *LCIA Notes for Parties* (https://www.lcia.org/adr-services/lcia-notes-for-parties.aspx).

[43] ICC Website, International Economic Sanctions (https://iccwbo.org/media-wall/news-speeches/international-economic-sanctions/).

[44] 2016 Russian Arbitration Association Survey: The Impact of Sanctions on Commercial Arbitration (https://arbitration.ru/upload/medialibrary/e1e/2016-raa-survey-on-sanctions-and-arbitration.pdf).

2.3. *Contracting for Sanctions.* — The increasing use of sanctions makes it more important for parties engaged in international contracts to consider their potential effect at the earliest possible stage, preferably when the contract is being negotiated and before any dispute arises. One option that parties have at their disposal is to specifically provide for the effect of sanctions in their contracts. This could be done by designating sanctions as a force majeure event and providing fully for the consequences of such an event arising in a force majeure clause or by including standard or custom sanctions clauses in a contract.

However, sanctions clauses should be carefully drafted so that it is clear what becomes of the rights and obligations of the parties once sanctions are imposed. An ideal position might be for the parties to the contract to represent and warrant to each other that as at the date of the contract, they are not subject to any sanctions (with "sanctions" carefully and specifically defined, possibly to include also secondary sanctions) and that if this is not true or sanctions are indeed imposed at a later date, the innocent party will have the right to terminate the contract. This can be particularly difficult in circumstances where parties either do not know what the nature of sanctions to be implemented in the future might be or the nature of existing sanctions changes during the lifetime of the contract. An unclear sanctions clause can lead to further confusion in the context of a dispute and, potentially, further litigation as to the meaning of the clause itself.

A good example of the need to carefully drafting clauses relating to sanctions arises from the English case *Mamancochet Mining v Aegis Managing Agency* [45]. *Mamancochet* concerned an ambiguous sanctions clause which necessitated litigation over the correct interpretation of the clause. The underwriter defendants claimed that they were not liable for theft of steel billets stored in Iran as a result of U.S. Iran sanctions because the marine cargo insurance policy included a sanctions carve-out employing standard-form wording developed by the Joint Hull Committee:

> "*no (re)insurer shall be liable to pay any claim...to the extent that the provision of such cover...would expose that (re)insurer to any [UN, EU, UK or U.S.] sanction, prohibition or restriction.*"

[45] Mamancochet Mining Ltd v Aegis Managing Agency Ltd & Others [2018] EWHC 2643 (Comm).

This clause gave rise to two problems of interpretation. First, there was a dispute as to whether "expos[ure]" to a sanction covered only actual breach of sanctions legislation or, additionally, the mere risk that a sanctions authority would come to the conclusion that sanctions had been breached. The Court concluded that only actual breach was covered by the clause as drafted. Second, there was a question as to whether the language specifying that the insurer is not liable "to the extent that" there is exposure to sanctions should be taken to mean that the obligations under the contract are extinguished or merely suspended. The Court concluded that the obligations would be suspended when the sanctions clause was triggered. This type of dispute around sanctions clauses shows that it is important to specify precisely what the trigger of the clause is and what the consequences for the parties to the clause are.

There are clear benefits to a carefully drafted force majeure or sanctions clause when a dispute arises as to whether a party can perform a contract affected by sanctions. However, practitioners should pay careful attention to the following when drafting such clauses:

(i) the type of sanctions involved, including their form, territorial effect and whether primary or secondary in nature;

(ii) what effect sanctions must have on the contract in order to trigger the clause;

(iii) the effect the clause will have on the parties' rights and obligations when triggered; and

(iv) when any suspensory effect of the clause will be lifted.

Parties who carefully prepare for the effect of sanctions will be best placed to avoid extended disputes when sanctions are imposed, which is a more foreseeable prospect now than ever before [46].

3. *Conclusion.* — The COVID-19 pandemic and its ongoing economic effects are likely to add strain to the current febrile geopolitical atmosphere and may accelerate the current trend of the increasing use of sanctions. In these circumstances, commercial parties, arbitration practitioners and arbitral institutions should consider sanctions at an early

[46] One interesting precedent to consider is the new ICC Force Majeure clause published in 2020. Since the previous version, the ICC have taken recent global developments into account by introducing "*currency and trade restriction, embargo, sanction*" as a "Presumed Force Majeure Event". However, for the reasons set out in this section, it will generally be preferable to define sanctions with more specificity.

stage. The flexibility of arbitration as a dispute resolution process creates unique opportunities for contracts to be structured and resulting disputes to be managed in the circumstances where sanctions are imposed in order to minimize their disruptive effect.

Parties engaging in cross-border business dealings must ensure that the effect of sanctions has been properly considered in the contract and that appropriate provisions, including robust dispute resolution clauses, provide for a sensible outcome where entities or affiliates involved in the contractual framework become subject to sanctions. As this article has shown, the multiplicity of different types of sanctions used by states (including secondary sanctions) means that detailed and specific definition of sanction events in the contract is generally optimal. Meanwhile, arbitrators and arbitral institutions must continue to implement rigorous screening and compliance processes to ensure that they do not fall foul of sanctions regulations.