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Impact of sanctions on international arbitration involving Russian parties: new developments

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Sanctions imposed by the USA, the EU and other jurisdictions in relation to certain *Russian* individuals and legal entities, since 2014, have had a substantial impact on *international arbitration* involving Russian parties.

The key problem caused by sanctions is not just that they are plentiful, contained in multiple sources of law and often complex. In my view, the worst factor, from the commercial perspective, is that it is impossible for a business to predict whether its counterparty, which is not subject to any sanctions at the time of entering into a commercial transaction, will be sanctioned in the future, as new sanctions are regularly introduced against new subjects without any obvious transparent logic behind them.

Moreover, the risk of application of "secondary" sanctions is almost impossible to quantify and assess as their application is completely arbitrary. As a result, the most conservative market participants may often find it easier to abstain from entering into any transactions with any Russian counterparties, even non-sanctioned parties, to minimise even the slightest potential risk.

Many practical issues involving sanctioned entities come up in arbitration. Such problems may arise at various stages of arbitration, including, for example, the *appointment of arbitrators*, instructing legal counsel, involving *experts*, participation of sanctioned persons as *witnesses*, payment of arbitration fees, expenses, and *costs*, and paying legal counsel.

If the *arbitral institution*, arbitrators, or legal representatives of the parties are domiciled in a jurisdiction that has imposed sanctions on a party to a dispute, they may be required to obtain an authorisation (often called a "licence") from a competent regulator in the relevant jurisdiction, allowing it to perform its role in the arbitral proceedings. For example, unless expressly authorised by the Office of Foreign Assets Control of the US Treasury Department (OFAC), a US person (whether a US national or resident, or a US law firm) would be extremely uneasy accepting an appointment to act as an arbitrator, counsel, or expert in an arbitration involving an entity under blocking sanctions. Even a non-US person needs to consider the risk of secondary sanctions if he or she gets involved in such an arbitration, as it can be argued that an *arbitral award* may facilitate a "significant" transaction with a sanctioned entity that is prohibited by US sanctions.

A significant practical impediment is that banks are likely to block/freeze any payments where either the payee or the payer is a sanctioned entity. This would lead to the possibility that any payment in US dollars or euros under the arbitral award could be blocked. That risk would also apply to the payment of arbitration fees and costs, and paying legal counsel and other parties in the arbitration proceedings.

Such risks have led many Russian entities, especially those under state control (and hence more susceptible to the potential risk of sanctions) to start opting for arbitration venues in Asia (*Singapore* and *Hong Kong* in particular), as opposed to more traditional arbitral forums in Europe. The recent trend of Russian parties choosing Asian arbitral venues may be reinforced in view of the changes made to the Russian Arbitrazh Procedure Code, which came into force on June 19, 2020 (*APC amendment*).

The APC amendment is aimed at protecting the interests of parties which have become subject to Russia-related sanctions, by extending the exclusive jurisdiction of the Russian state commercial "arbitrazh" courts to disputes with

such sanctioned parties. As a result, any prorogation or *arbitration agreement* entered into by a Russian sanctioned party, and providing for an arbitral forum or a *seat of arbitration* in a jurisdiction that has adopted Russia-related sanctions, is potentially unenforceable in Russia.

Pursuant to the APC amendment, if a sanctioned party has submitted to the jurisdiction of a non-Russian court or an arbitration tribunal in a state where such party's "access to justice" might be limited by the application of Russia-related sanctions, then such sanctioned party is entitled to bring its claim in a Russian court. As the APC amendment does not explain what circumstances might be regarded as sufficient to bar a party's access to justice, in theory, any difficulty encountered by a sanctioned person could be construed as a limitation of access to justice. Even the imposition of sanctions in itself could probably be re-characterised as such.

If the sanctioned party's procedural opponent continues to pursue a claim against the sanctioned party in a foreign court or arbitral tribunal in the above scenario, the sanctioned party may apply to Russian court for an anti-suit injunction. Should the opposing party fail to comply with an anti-suit injunction granted by a Russian court, the APC amendment specifically entitles the Russian court to impose a penalty on the non-complying party in the amount of the entire claim brought in the foreign court or tribunal, plus any associated costs, in favour of the sanctioned party.

Of course, it is quite possible that an international arbitration tribunal will uphold the *arbitration clause* and continue with the arbitration, disregarding the Russian court's anti-suit injunction. However, in relation to any Russian assets, this would result in a significant risk to a non-sanctioned party pursuing a claim against a sanctioned party outside Russia. This is because the Russian court's penalty would be enforceable against any assets that the non-sanctioned party may have in Russia.

Furthermore, the likelihood of enforcement of a foreign arbitral award in Russia in these circumstances would be close to zero. The enforcement of a foreign arbitral award pursuant to the *New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958*, to which Russia is a party, is likely to be barred due to the "public policy" argument based on the explicit provisions of the APC amendment.

So, where does that leave parties to cross-border deals with Russian parties?

I believe that the risk of application of the APC amendment to cross-border commercial transactions may inhibit the ability of Russian parties to enter into such transactions. This is because their foreign counterparties may be scared away, not just by Russia-related sanctions, but now also by the protectionist measures taken by the Russian state, particularly if they cannot rely on their ability to resolve potential disputes with their Russian counterparty in a mutually accepted neutral forum, under applicable law agreed by the parties in their contract.

However, in my view the risk of application of the APC amendment could be minimised if the following factors were to apply to the dispute in question:

- The arbitral institution and the seat of arbitration are in a jurisdiction that has not imposed any Russia-related sanctions.
- The applicable law cannot be construed as including the sanctions provisions as overriding mandatory provisions.
- The arbitration is administered by a permanent arbitral institution recognised by the Russian Ministry of Justice.

If all of the above factors were met, it would be difficult for a sanctioned party to argue that its "access to justice" was unduly limited because of the application of sanctions.

At present, the *Hong Kong International Arbitration Centre (HKIAC)* is the only well established and popular international arbitral venue that meets all of the above criteria. First, Hong Kong has not imposed any Russia-related sanctions. Furthermore, the HKIAC is one of only two non-Russian permanent arbitral institutions (PAI), and the only non-EU PAI, that is accredited by the Russian Ministry of Justice.

The *HKIAC PAI status* is quite important for Russian law purposes as it provides a number of key procedural advantages as a matter of Russian law, including, but not limited to, an ability to:

- Administer a dispute with a seat of arbitration in Russia.
- *Resolve certain corporate disputes* which are otherwise non-*arbitrable* as a matter of Russian law.
- Waive certain forms of judicial supervision and interference by Russian state courts.

The *Vienna International Arbitral Centre (VIAC)* also has *PAI status* for Russian law purposes. However, Austria is part of the EU; therefore, EU sanctions may apply to relevant parties.

The *Singapore International Arbitration Centre (SIAC)* has also become popular with Russian parties. Singapore has not imposed any Russia-related sanctions, but the SIAC lacks PAI status at present.

Of course, the above described advantages of HKIAC may not always be a 100% solution to all potential numerous sanctions related issues. However, it certainly presents a viable alternative to more traditional arbitral venues in Europe. One may expect that its popularity in relation to Russia-related disputes will continue to grow.