Reviewing Sanctions in Arbitration: The Good, the Bad, and the Ugly of Private International Law Analysis

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by Naimeh Masumy, [nmasumy@gmail.com]

The growing role of arbitration as a peaceful means for resolving investment, commercial and inter-state disputes is now impacted by an increasing number of sanction regimes borne out of the recent geopolitical conflicts. Following Russia's invasion of Ukraine, many regulators across various jurisdictions sought to move towards greater coordination of sanction implementation and enforcement efforts. The recent tranche of sanctions has sparked a debate on the appropriate standards of review that arbitral tribunals ought to apply when dealing with disputes involving sanctions.

In this short note, we look at the case of *Sofregaz v. NGSC,* which provides a sobering exposition of the challenges faced by the adjudicative bodies when assessing the legality of unilateral Extra-territorial sanctions under international law. This case concerns the annulment of an arbitral award rendered in Paris 2018 in favor of NGSC, pursuant to the Rules of Arbitration of the International Court of Arbitration of the International Chamber of Commerce (ICC Rules). In 2018, the ICC tribunal found against Sofregaz and awarded NGCS an amount of over USD 2.4 million for an unpaid invoice and down payment drawn by Sofregaz under certain guarantees. Sofregaz applied to set aside the award before the Paris Court of Appeal. It sought an annulment application based on NGSC's exposure to US secondary sanction. Sofregaz argued, *inter alia*, that the tribunal had failed to carry out its mandate and had not considered the impact of sanctions against Iran on the performance of the contract. In Sofregaz's view, this resulted in an award contrary to French international public policy in that it gave effect to a contract that could not be performed without breaching the designated

sanctions. The Court of Appeal dismissed the annulment application brought by the Sofregaz, using private international law analysis to dismiss the legality of U.S. sanctions.

This note will highlight why invoking such a private international law analysis when determining the validity and the scope of applicable sanctions will undermine international arbitration. Then, it will show that such an analysis is inconsistent with the overriding objectives of international arbitration – arguably, the creation of an autonomous dispute resolution system for the effective and expeditious resolution of disputes in a delocalized fashion.

The Relevance of Private International Law Analysis to Arbitration

Private international law provides a judicial tool for courts to address the distinction between forum law and foreign law and promotes a smooth functioning of the international legal regime by mitigating jurisdictional conflicts, especially in a legal relationship involving several applicable laws. Courts weigh private and public policy concerns of the forum law and foreign law when determining whether to apply the laws of a foreign jurisdiction over the forum law.

Many scholars have strongly advocated the use of private international law analysis in international arbitration. The benefits of such analysis are particularly clear when arbitrators are faced with potentially conflicting laws, similar to the case of Sofregaz v. NGCS. where the tribunal was confronted with three different sets of laws: Iranian law governing the contract, French law as the law applicable at the seat of arbitration, and the U.S. law governing the sanctions regime, albeit extraterritorially imposed, which materially impacted on the performance of a contract. The tribunal did not consider the impact of US sanctions, and rendered an award in favor of NGSC due to the wrongful termination of a contract for the conversion of a gas field.

In such instances, private international law can operate as a mechanism of localization that permits tribunals to adjudicate in cases involving several legal orders by taking into account important considerations such as overriding mandatory rules at the seat of the arbitral tribunal.

Arbitrators are generally empowered to apply the law deemed “appropriate” or “applicable” in the absence of a governing law clause. Notably, Article 22(3) of

the 2020 LCIA Rules also authorizes arbitrators, when determining the *lex contractus,* to apply the rules of law they deem appropriate. Such approaches can provide objective yardsticks for tribunals exercising their discretion to select the appropriate law. Having objective criteria aids predictability and efficiency and ensures tribunals do not act outside their designated mandates.

This is of particular significance as the uncertainty over the governing law may negatively affect the parties' due process rights and may lead to the award being issued arbitrarily. Such concern was echoed in the *Sofregaz* application to set aside the award in 2019, in which it was claimed that the tribunal failed to take into account the impact of U.S. economic sanctions. Thus, that award recognition would be contrary to international public policy ("l'ordre public international").

The court dismissed the claim observing that the Tribunal did not violate international public policy in failing to consider the impact of U.S. economic sanctions. To this end, the French court defined international public policy as "the body of rules and value whose violation the French legal order cannot tolerate, even in the international context." In its reasoning, the court heavily endorsed French conflict-of-laws rules to determine the contour of mandatory rules. This approach means that if a tribunal relies on objective criteria to take into account essential regulations of the forum such as domestic and international mandatory law, the final award may remain immune from potential challenges. In other words, private international law analysis may be a desirable straight jacket to ensure that tribunals comply with regulatory provisions of the forum. As such, it may enable courts to establish trust in arbitration and refrain from inquiring into the merits of final awards.

Conflict of Rules Analysis: Undermining the Delocalization Theory

The delocalization theory of arbitration is a part of the much broader, which posits that international arbitration ought to be completely detached from the procedural and substantive law of the place of arbitration or the seat, or *lex loci arbitri*, and from national law in general. According to this theory, arbitration is a private activity, which can be considered favorably or unfavorably, but certainly does not need to be empowered by any state ex ante. While this theory found a firm grounding under the French law of international arbitration, in reality, this theory usually carries little weight, especially in enforcing an award that has been challenged. The theory of delocalization begins to wane, as the legal system of the

forum country will be the primary source relevant to ascertaining the legal relationship of the final award and the mandatory provisions of the *lex fori.*

In addition, the New York Convention muddies the waters by making reference to domestic public policy in article V (2) (b) as a ground for non-recognition or enforcement of an award., Based on the literal reading of the Convention, the law of the seat of arbitration usually delineates. Thus, to contextualize international arbitration through the prism of absolute delocalization, a system wholly emancipated from the forum law will pose practical challenges.

The above is of relevance to the role of sanctions for arbitral awards. Private international law is predicated on the notion that the world is divided into nation states and national legal orders. This approach dramatically contrasts with what international arbitration delocalisation theory arguably has long sought: to free arbitration from national orders. According to this view, examining the validity and scope of sanctions through the prism of private international law analysis forces the arbitrator to draw upon domestic law. This, in turn, contravenes the main tenet of delocalization theory, which confirms that arbitration has no forum. Further, the arc of modern arbitration laws arguably negates the relevance of private international law analysis. Modern arbitration laws are mostly substantive laws, and the notions embedded in arbitration are substantially transnational rather than international, which undermines the viability of the private international law analysis.

Private International Law Analysis: A False Aura of Objectivity

Despite the widespread view that private international law provides a roadmap towards a more predictable and objective outcome for disputes involving sanctions, such framework is prone to inconsistent and divergent results. Private international law provides a basis of jurisdiction to apply foreign law when several laws may concurrently apply to the dispute. In doing so, private international law approaches balance competing interests according to notions such as reciprocity, expectation of courtesy and comity. The exact contours of these notions have remained imprecise, as the U.S. Supreme Court noted in the case of *Hilton v. Guyot.* Courts often draw upon their ideology and values explicitly and implicitly to ascertain comity. Such assessment will inadvertently lead to adjudicators interposing *ad hoc* political judgments about foreign relations, opening a door for arbitrators to endorse parochial domestic policies to ascertain the legal orders

involving international components. This is evident in the French Court's reasoning, in which the court heldthat "[t]he unilateral sanctions taken by U.S. authorities against Iran cannot be regarded as the expression of an international consensus, since the French authorities dispute the extraterritorial reach of these sanctions". This assessment was drawn by balancing the interests of French national policies, which denotes that relying on political considerations rather than legitimate international considerations concerning the legality of sanctions will open the door for domestic idiosyncratic views and interpretations, which in turn, will bar this concept to be applied hegemonically across different jurisdictions.

If the governing law of sanctions is determined by private international law, it may pose conceptual difficulties. Sanctions are international instruments hinging on the notion of sovereign equality. The underpinning principle of sovereign equality of states is deeply embedded in one of the main tenants of international law. Any actions impinging on that principle would therefore need to involve considerations of public policy. Public international law must impose limits to the scope and validity of sanctions and to governing law. To this end, using private international law approaches to ascertain the validity of sanctions will negate the character (or nature) of sanctions as a public international law instrument transcending national boundaries

Conclusion

This post has called into question the viability of a private international law analysis in reviewing the scope of the application of sanctions. It has contended that a private international law analysis borrows its genesis from the domestic law of the forum (state). Private international law analysis needs to have sufficient normative weight to scrutinize or inquire into the substance of sanction regimes. Further, invoking private international law principles does not preclude arbitrators from engaging in subjective assessments to examine the applicability of a sanctions regime. By abandoning a private international law analysis, the interpretation and enforceability of sanctions will become more anachronistic and predictable.