When Economic Sanctions Lead to Conflict of Laws and Real Risks for Businesses

Economic Sanctions and Risks for Businesses

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1 Introduction

Nation states have used international trade and economic sanctions (hereinafter “economic sanctions” or simply “sanctions”) as a foreign policy tool in international relations for many decades. After the Second World War, the use of sanctions was explicitly included in the Charter of the United Nations (UN) as a legitimate method available for the UN Security Council (unsc) to combat the threat to peace or acts of aggression.[[1]](#footnote-1)

In recent years, countries have however departed from the multilateral framework of the unsc and instead acted either in a coordinated approach, as in the case of United States (US) and European Union (EU) sanctions against Russia, or unilaterally, as in the case of EU’s autonomous sanctions against, for example, Belarus[[2]](#footnote-2) and Turkey.[[3]](#footnote-3) This departure from the multilateral framework is due in part to the tension in the membership of the unsc, in which Russia and China each have a permanent seat. It is therefore inconceivable for example that the unsc would adopt sanctions against Russia for the annexation of Crimea or more recently, for its invasion and war against Ukraine. Instead, as the recent example of the coordinated sanctions against Russia show, the EU and the US are able to coordinate the scope of their sanctions regimes, which also paves the way for alignment by other Western countries. The example also illustrates another feature, namely, that the US is able and also willing to impose broader sanctions targeting many more companies and individuals. In fact, it is fair to say that the departure from multilateral coordination, towards a unilateralism, and the uncoordinated and somewhat unpredictable imposition of sanctions has become a signum for the US administration.

Another particular characteristic of US sanctions is the approach of extending the scope of application of some of its sanctions regimes. In those cases, the sanctions regimes not only target legal and natural persons subject to US law, but also anyone in the world outside US jurisdiction, who acts in breach of the purpose of US sanctions thus giving the regime an “extraterritorial” effect. The most prominent example of this is US sanctions against Iran. This extraterritorial effect of US sanctions has led to counterreactions and the imposition of legislation to limit these effects, making it illegal to comply with such US sanctions, as is the case with the EU’s Council Regulation (ec) No. 2271/96 (Blocking Statute).[[4]](#footnote-4) These actions and counteractions, has in turn led to an internationally complex set of conflicting laws, and businesses trying to act in this context are genuinely caught between a rock and a hard place, having to choose what laws to comply with and what laws to effectively turn a blind eye to.

In addition, the international banking system is heavily dependent on complying with US sanctions, which effectively leads to an extension of US sanctions even further than their intended scope. This in turn leads to a hampering effect on sanctioned individual’s ability to get their cases tried in arbitral proceedings. Ultimately, sanctions can thus also have the effect of denial of access to justice.

This chapter analyses the UN, EU and US sanction regimes by describing their jurisdictional scope, their similarities and differences, as well as the severe implications and uncertainty for companies due to sanction regime’s overreaching jurisdiction. It also provides two specific examples to illustrate how these conflicting laws result in risks for companies.

2 Jurisdictional Scope of Sanctions Regimes

2.1 UN Sanctions

The adoption of UN sanctions is determined by the unsc. Sanctions measures, under Article 41 of the Charter of the United Nations,[[5]](#footnote-5) encompass a broad range of enforcement options that do not involve the use of armed force.

However, as the permanent members, such as Russia and China, have veto right, sanctions are often not adopted in relation to conflicts where there are conflicting interests between these permanent members. The UN General Assembly also has powers to establish sanctions programs, but does not do so in practice.[[6]](#footnote-6)

Since 1966, the unsc has established in total 30 sanctions regimes, covering: Southern Rhodesia, South Africa, the former Yugoslavia (two), Haiti, Iraq (two), Angola, Rwanda, Sierra Leone, Somalia and Eritrea, Eritrea and Ethiopia, Liberia (three), drc, Côte d’Ivoire, Sudan, Lebanon, dprk, Iran, Libya (two), Guinea-Bissau, Central African Republic, Yemen, South Sudan and Mali, as well as against isil/isis (Da’esh) and Al-Qaida, and the Taliban. Today, 14 of these regimes are still active.[[7]](#footnote-7)

Since the late 1990s, the use of sanctions by the UN has shifted from embargos (also known as comprehensive sanctions) targeting whole states and regions, to so-called targeted sanctions, targeting only listed individuals and entities. The aim of such targeted sanctions is to coerce the elites and responsible individuals and entities of a certain regime or group to change their and the regime’s conduct while limiting the negative effects on the civil population in the country or region in question. The effect of being targeted by sanctions usually means that the individual’s or entity’s assets are frozen and that trade with such persons or entities are prohibited – a form of trade ban against them.[[8]](#footnote-8)

UN sanctions are not directly binding upon individual actors as they require incorporation by national and regional lawmakers to become binding and effective. In other words, the UN does not have jurisdiction over any individual actors, only over its UN member states. Some countries, such as Sweden, will however have national laws, through which UN sanctions become directly applicable at the time they are adopted in the UN.[[9]](#footnote-9)

In the EU, the adoption of sanctions, including new UN sanctions, is done through a legislative procedure at the European Council. However, this incorporation into EU law requires unanimity amongst the EU member states, which has on occasion led to a delay due to political tension and negotiations.[[10]](#footnote-10)

2.2 EU Sanctions Regimes

2.2.1 Evolution and Decision-making in EU Sanctions Regimes

EU sanctions are based on the Common Foreign and Security Policy,[[11]](#footnote-11) and are adopted through Council decisions.[[12]](#footnote-12) All EU member states are thus involved and agree through the unanimous adoption of new sanctions. The sanctions regimes are usually imposed through a Council decision and a parallel Council regulation. The latter is needed to introduce a legally binding EU act which is applicable and binding on all persons and entities in the EU.

There are two typical EU sanctions regimes; country-based regimes and global thematic regimes.

The EU currently has a number of country-based sanctions regimes, targeting *e.g.* Russia, Venezuela, Sudan, Lebanon, Afghanistan, etc.[[13]](#footnote-13) The most recent examples of EU country-based sanctions are the very extensive sanctions regimes imposed against Russia and Belarus due to Russia’s invasion of Ukraine.[[14]](#footnote-14)

The EU’s country-based sanctions will most often impose strict restrictions on engaging in economic activity with a targeted individual or entity. Such individuals and entities are subject to an asset freeze, meaning that banks will freeze their account, and a prohibition to provide such individuals and entities directly or indirectly with any economic resources. The latter in effect means a trade ban against such individuals and entities.

In addition to targeting individuals and entities, such sanctions are often coupled with export restrictions on specific products to specific industries or for specific purposes. For example in the new sanctions against Russia, the EU and US coordinated a broad list of equipment subject to an export and sales ban, which encompassed equipment and software deemed useful for Russia’s defence and security industry.[[15]](#footnote-15) The EU also sometimes escalates its sanctions regimes, in cases where the situation in the targeted country deteriorates, and adds new persons to the lists of sanctioned individuals and entities, or adds new sectors or products with which it is prohibited to engage in any business. The sanctions against Iran (before the Joint Comprehensive Plan of Action (jcpoa), (discussed below) and Syria are historic examples of the most extensive sanctions regimes imposed by the EU.[[16]](#footnote-16) The new sanctions against Russia and Belarus are equally comprehensive, but because of the EU’s dependency on oil and gas from Russia, the sanctions have not (yet) covered Russian exports and have not (yet) banned financial transactions with Russian banks involved in payment for oil and gas.

Following the trend in the US, the EU has lately increased its adoption of thematic regimes. These include sanctions against the proliferation and use of chemical weapons which was introduced in 2018,[[17]](#footnote-17) and sanctions against cyber-attacks threatening the EU or its member states, which was introduced in 2019.[[18]](#footnote-18) So far very few individuals or entities have been added to these sanctions lists.[[19]](#footnote-19)

One reason for the difference between the US and the EU in scope and approach, can be found in the political negotiations often involved between different member states in the EU. In 2017, the US introduced a new thematic sanctions regime called the Global Magnitsky Program (“Magnistsky sanction”), to target individuals and entities involved in serious corruption and human rights violations. At present, the program has listed 243 individuals and entities in 28 different countries.[[20]](#footnote-20)

In December 2020, after a long period of political discussion regarding the poisoning of the Russian opposition leader Alexei Navalny, the EU introduced a new sanctions regime against serious human rights violations and abuses.[[21]](#footnote-21) Both the European Parliament and the European Commission had publicly called the member states to agree on the adoption of this sanctions regime and also to change the adoption process to move to qualified majority instead of unanimity, in order to limited the risk of political negotiations blocking the adoption of new sanctions.[[22]](#footnote-22) Contrary to the US Magnitisky sanctions, the EU’s sanctions regime focuses on human rights abuses only and cannot be used to target foreign individuals or entities involved in corruption.

A comparison with the US Magnitsky sanctions and the EU human rights sanctions regime provides an illustrative example of the difference in law-making ability. The US is able to impose new sanctions more swiftly, whereas the EU, due to political negotiations between member states, struggled for an awkwardly long time to reach the required unanimity. This exposes the weakness of the EU, that is the delay caused by political bargaining on a topic (human rights) which is after all a fundamental value for the EU.[[23]](#footnote-23) In view of the contentiousness and slowness in imposing human rights sanctions, when Russia invaded Ukraine, the swift and coordinated imposition of sanctions by the U.S. and the EU almost came as a surprise. However, Russia’s long military build-up at the Ukrainian boarder and the newly strengthened ties between Brussel’s and the Biden administration, provided timely and like-minded platforms for the EU and U.S. to coordinate and tailor extensive sanctions packages in a very effective manner.

Turning to the question of jurisdiction, compared to US sanction regimes, the EU has a very straight forward and consistent approach.

2.2.2 Jurisdiction of EU Sanctions

EU sanctions usually apply a standard clause, which sets out the jurisdictional scope of the economic sanctions in question. The clause is in principle identical in all sanctions regimes and has the following wording.

This Regulation shall apply:

(a) within the territory of the Union, including its airspace;

(b) on board any aircraft or any vessel under the jurisdiction of a Member State;

(c) to any person inside or outside the territory of the Union who is a national of a Member State;

(d) to any legal person, entity or body, inside or outside the territory of the Union, which is incorporated or constituted under the law of a Member State;

(e) to any legal person, entity or body in respect of any business done in whole or in part within the Union.[[24]](#footnote-24)

The above wording is considered by the EU to be compliant with the principles on jurisdiction in international law, in short meaning that there is enough of a link or connection with the EU for the prohibitions and restrictions in a sanctions regulation to be applicable. Thus, a person with Swedish nationality, is thus by law (the sanctions regulation at hand) required to comply with the regulation, even when that person travels abroad. Further, companies established in Sweden are required to follow the sanctions, as well as any affiliates abroad. However, subsidiaries which are their own legal entities established outside of the EU, are not covered by the scope of the regulation.

The last point above,“any legal person, entity or body, in respect of any business done in whole or in part within the Union” could potentially be said to have some form of extraterritorial reach. For example, this provision could catch non-EU nationals that do part of their business through the EU, *e.g.* through brokering on an EU website.

The EU is keen however to claim that it applies sanctions in accordance with international law, and that it refrains from extraterritorial application. The EU’s Guidelines on sanctions, explain the EU’s standpoint and refers to the so-called Blocking Statute (discussed below), as the way in which it condemns other countries’ extraterritorial sanctions:

The EU will refrain from adopting legislative instruments having extra-territorial application in breach of international law. The EU has condemned the extra-territorial application of third country’s legislation imposing restrictive measures which purports to regulate the activities of natural and legal persons under the jurisdiction of the Member States of the European Union, as being in violation of international law.[[25]](#footnote-25)

EU sanctions regulations are directly applicable to any individuals and entities under their scope. However, as regards enforcement, it is up to each EU member State to lay down the rules on penalties applicable to infringements of the provisions of such regulations. The penalties provided for under such national law shall be effective, proportionate and dissuasive, but evidently vary to a great extent between the different member states.[[26]](#footnote-26)

Although the EU’s sanctions regimes do not have extraterritorially application, a certain departure from this principle can be detected in the recent sanctions against Russia and Belarus. Even if the legal provisions have not changed, the European Commission has been active and published numerous guidance documents to explain how sanctions provisions should be interpreted and these documents recurringly refer to the prohibition on circumventing sanctions. Thus, for example, an EU parent company cannot, at least actively, allow its subsidiary in Russia to engage in the type of activities that the EU parent company would be prohibited, under EU sanctions, to engage in. These new and numerous sanctions guidelines have been produced at a very quick rate, and sometimes provide extensive interpretations of provisions that are already quite broad in scope. Enforcement and subsequent court actions might be expected on these provisions, which in turn will determine how far the sanctions provisions should actually be applied.

2.3 US Sanctions Regimes

Sanctions have for a long time been a part of US foreign policy as a way to create economic pressure on specific governments, companies or individuals if they are acting against US foreign policy or national security objectives.[[27]](#footnote-27) Today, the US maintains a very broad range of different types of sanctions, both thematic and country-based.

The different types of US sanctions can be categorized as comprehensive, sectoral and list-based. The comprehensive embargos applies to specific regions or countries and prohibits US persons from engaging in the specific jurisdiction, including measures such as facilitating exports, imports and financial transactions.[[28]](#footnote-28) The sectoral sanctions are usually those that target certain sectors within a country’s economy, that generate income to the government. These sanctions have been used to prohibit US persons and persons within the United States from engaging in certain transactions with targeted individuals and entities in, for example, Russian industries such as the energy, mining, engineering or defence sectors in Russia.[[29]](#footnote-29) The third category of sanctions is, as in the case of UN and EU, list-based sanctions, which refers to a number of governmental sanctions lists of specific individuals, companies, governments etc. There are several different lists, including the most known, *i.e.* the Blocked Persons List and the Specially Designated Nationals (the sdn List).[[30]](#footnote-30) As with EU sanctions, US persons are prohibited from facilitating transactions with these persons and their property. Furthermore, all assets or property owned by such listed persons or entities which are subject to US jurisdiction are frozen.[[31]](#footnote-31) Thus, in short, as in the case of the EU sanctions, the list-based sanctions result in a trade ban against the persons or entities on those lists.

The question of jurisdiction and to whom US sanctions shall apply, is perhaps one of the most complex issues when trying to understand US sanctions. Contrary to the EU’s uniform approach, the language of each sanctions regime determines its scope. Thus, different sanctions regimes may target differently. Also, the US has developed certain theories of jurisdiction, which extends jurisdictions through different means of nexus to the US. In addition, and most severely, some sanctions regimes allow for the imposition of US sanctions against non-US persons and entities simply because they act in a way which is contrary to US sanctions. To facilitate the narrative around this complex structure, US sanctions are usually categorised as either “primary sanctions” or those with more extended applicability, *i.e.* “secondary sanctions”.

2.3.1 Primary Sanctions

2.3.1.1 Concept of US Person and US Nexus

A primary sanction regime applies to individuals and entities falling within the US legal jurisdiction.[[32]](#footnote-32) This is usually defined in the regulation as applying to “US persons” or in situations when there is a “US nexus”, and there is a clear connection to the US jurisdiction. The term US person includes:

/…/all U.S. citizens and permanent resident aliens regardless of where they are located, all persons and entities within the United States, all U.S. incorporated entities and their foreign branches.[[33]](#footnote-33)

The concept of a “US nexus” refers to situations when an activity involves a US person or touches US jurisdiction. A US nexus can therefore exist when a transaction involves a US-person at a company, includes US-origin services or goods, is facilitated through a payment in US dollars or takes place on US territory.[[34]](#footnote-34) Therefore, a non-US person may violate a US primary sanction if it is involved in a transaction that has a US nexus, for example, simply by engaging in a payment of goods in US dollars.

2.3.1.2 Applicability to Non-US Person because of US Nexus

The scope of primary sanctions may sometimes expand to non-US companies established outside of US jurisdiction if they are owned or controlled by US companies, *i.e.* a foreign subsidiary of a US entity (Iran and Cuba).[[35]](#footnote-35)

Furthermore, both US and non-US persons may be caught through an action that “causes” a violation of sanctions. This has resulted in an extraterritorial effect of US sanctions when only a very limited US nexus is at hand. The situation arise when, for example, a non-US person (A), engage in a transaction with either a sanctioned targeted person (*e.g.* an sdn-listed person) or country (B) *causing* a US-person (C) to violate a primary sanction. This theory of “causing” has been used primarily in situations when a non-US person (A) uses US dollar as payment in transactions with the sanctioned party (B) causing the US bank (C) to violate a sanction, *e.g.* making (C) process US dollars to Iran.[[36]](#footnote-36) A non-US person conducting transactions using US dollars must therefore be aware of the risk of becoming subject to US sanction even if there are no other US nexus then the choice of currency.[[37]](#footnote-37)

2.3.2 Secondary Sanctions

2.3.2.1 Non-US Persons without US Nexus

The US imposition of secondary sanctions is not a completely new feature. During the 1990s, secondary sanctions were imposed against the petroleum sectors in Iran and Libya. Two of the most important sanctions programs with secondary provisions are those against Russia and Iran.[[38]](#footnote-38) The US sanctions programs which contain “secondary sanctions” provisions go beyond the reach of primary sanctions. The expanded scope is the result of secondary sanctions not requiring any US nexus at all.[[39]](#footnote-39) These provisions aim at influencing the behaviour of non-US persons acting outside of US jurisdiction who are conducting, what is viewed as, acts contrary to US foreign policy and national security objectives. Usually, the secondary sanctions provisions will, by definition, apply to “any person” instead of a “US person”.

As an example, the US sanctions against Russia includes certain provisions under which the US administration can target foreign individuals that engage in “significant trade” (discussed below) with a person or entity already listed in US sanctions against Russia. As explained by the US Treasury, these provisions:

a mandatory sanctions provision on foreign persons that Treasury determines, inter alia, knowingly *facilitate significant transactions*, including deceptive or structured transactions, for or on behalf of *any person subject to U.S. sanctions with respect to the Russian Federation*, or their child, spouse, parent, or sibling.[[40]](#footnote-40) (emphasis added)

A key criteria in the above provision is that the trade should constitute a significant transaction. However, instead of delimiting the scope of the secondary sanction, this wording in practice actually adds to more uncertainty. The reason is that the definition of what constitutes a significant transaction is determined on a case-by-case basis with respect to several different broadly defined factors:

(1) the size, number, and frequency of the transaction(s); (2) the nature of the transaction(s); (3) the level of awareness of management and whether the transaction(s) are part of a pattern of conduct; (4) the nexus between the transaction(s) and a person subject to sanctions imposed by the United States with respect to the Russian Federation; (5) the impact of the transaction(s) on statutory objectives; (6) whether the transaction(s) involve deceptive practices; and *(7) such other factors that the Secretary of the Treasury deems relevant on a case-by-case basis.*[[41]](#footnote-41) (emphasis added)

These factors, in particular the uncertain nature of the seventh factor, complicates any assessment for a non-US person of whether a specific transaction would be deemed significant. Thus, one effect of this vague definition, is that it is interpreted very cautiously, and thereby effectively deterring business that might be seen as lawful by the US authorities.

If a company breaches a secondary sanction, several severe effects may occur. For example, if an EU-based company engages in significant trade with a Russian sdn-listed entity, the EU company may itself become a designated entity (an sdn) and thus subject to US primary list-based sanctions.[[42]](#footnote-42) This applies despite a lack of any US nexus in the transaction. Such a designation would effectively mean that no US person would be allowed to interact with the EU company, and the company’s accounts would be frozen by US banks.

Such a designation would thus exclude the company from the US markets and the US financial system, including access to trade in US dollars. Most banks in the western hemisphere are reliant on access to the US financial system and thus also clearing functions with US banks. EU banks are therefore very cautious of the draconian effects of being designated under US sanctions, as well as the commercial risk of US banks no longer be able to interact with them. A further factor to consider in this context is that the US enforcement authorities, during the last decade, have charged a large number of EU-based banks for violating US sanctions. This has led to comprehensive settlements agreements and historically high fines for the banks involved.[[43]](#footnote-43) Some banks have made very strict compliance commitments and others simply apply a more cautionary approach and do not allow their customers (bank account holders or loan takers) to receive or make payments to an sdn-listed entity, even when there is no US nexus or US secondary sanctions provisions in the sanctions program at hand. Many financial agreements have very strict compliance requirements on the loan taker, which further extends the compliance requirements onto the businesses community.

In sum, the effectiveness of, and the adherence to US sanctions is to a major extent attributed to the international banking sector’s cautionary approach, due to the experiences with enforcement of US sanctions. As the banking sector extends the perceived compliance requirement onto its customers, US sanctions are in practice very extensively implemented in global business transactions. This effectively also extends US sanctions, and often gives them an even wider extraterritorial effect then what is actually meant in US jurisdiction.[[44]](#footnote-44) To illustrate this point, when the EU and U.S. coordinated sanctions against Russia, they chose which Russian banks would be sanctioned and how, in order to not prevent the EU from being able to pay for oil and gas (e.g. by not listing Sberbank and Gazprombank as an sdn s).

3 The Blocking Statute

The Blocking Statute is one of several measures taken in attempts to counter the jurisdictional overreach caused by secondary sanction programs implemented by different regimes. The basic principle of the Blocking Statute is that the EU recognises laws adopted by third countries with extraterritorial effect as unlawful under international law. EU operators[[45]](#footnote-45) are therefore prohibited from complying with such legislation and have certain notification requirements when they encounter a listed extraterritorial legislation.[[46]](#footnote-46)

At present, the regulation addresses the US extraterritorial sanctions legislation against Iran and Cuba.[[47]](#footnote-47) Nonetheless, the Blocking Statute purports to offer three different types of protection to EU operators: (i) nullification of the effect in the EU of foreign decisions taken by a third country authority based on the legislations listed in the Annex of the Blocking Statute,[[48]](#footnote-48) (ii) allowing EU operator to seek compensation for any loss it has suffered arising from the application of the listed extraterritorial legislation,[[49]](#footnote-49) and (iii) enabling EU operators, in specific circumstances, to request an authorization to comply with the listed extraterritorial legislation.[[50]](#footnote-50)

EU operators have found themselves in the difficult or even impossible position to comply with both the US sanction regulations in the Annex of the Blocking Statute, and the Blocking Statute at the same time. Only very few court proceedings concerning the Blocking Statue have been handed down.

The ultimate interpreter of the Blocking Statue and how it should apply would be the European Court of Justice. At present, there are two cases pending which relate to the Blocking Statute, but as of yet, these have not yet been tried.[[51]](#footnote-51) As of 12 May 2021, the Advocate General’s Opinion was published in Case C-124/20 Bank Melli, expressing an intermediate way. EU operators may terminate a commercial relationship with an Iranian bank subject to US sanctions if it can demonstrate “that they are actively engaged in a coherent and systematic corporate social responsibility policy which leads them, inter alia, to refuse to deal with any company having links with the Iranian regime”. This means that the EU operator “must demonstrate to the satisfaction of the national court” that it did not terminate an otherwise valid contract with the Iranian entity subject to US sanction due to their sanctions listing.[[52]](#footnote-52) The pending court rulings at EU level could thus change the dynamics of US sanctions making it more difficult for EU operators and EU-based banks to object to business with Iran and Cuba, but this remains uncertain.

However, notably, as the Blocking Statute does not (yet) encompass US secondary sanctions against Russia, there is no prohibition for EU operators to comply with US sanctions and there is therefore less risk of refraining from business with for example, Russian sdn s. Still, the US and EU sanctions against Russia have the effect of hampering or complicating existing trade. The following section will therefore address the Russian counteractions to the Western countries’ introduction of sanctions, and thereafter exemplify the difficult situation for businesses operating in this internationally complex set of conflicting laws through two cases studies.

4 Russian Countermeasures against EU and US Sanctions

Already in response to earlier EU and US sanctions against Russia, Russian authorities had taken a series of measures to mitigate the sanctions’ effect on the state economy.[[53]](#footnote-53) Measures taken included (i) restrictions of disclosure of ownership information from the Unified State Register of Legal Entities in relation to Russian companies owned or controlled by sanctioned persons; (ii) increased import customs duties; and (iii) the imposition of import bans.

At the moment of these measures, Russia did not have a clear legal background for taking them. Thus, the range of measures was rather limited in its content and/or duration. To tackle this problem, in 2020, Federal Law No. 127-fz “On measures (countermeasures) in response to the hostile acts of the USA and other foreign countries” was adopted. This law laid down a legal framework for new countermeasures. For example, Russian authorities may now terminate or suspend international cooperation of the Russian Federation or Russian organisations with so-called unfriendly foreign states. This could include restricting foreign or Russian-based companies with *e.g.* US shareholders from taking part in public procurement.

To counter denied access to justice, in June 2020, the Russian Parliament also amended the Commercial Procedure Code (the cpc). The amendment creates a right for persons and legal entities that suffer from restrictive measures imposed by “unfriendly foreign states” to refer their contractual disputes to state courts in the Russian Federation. This applies even if the contract in question would State that all disputes are to be settled by arbitration in a particular jurisdiction (for example Sweden).[[54]](#footnote-54) In the course of parliamentary readings, the draft law’s original text has been substantially revised in favour of a more abstract regulation.[[55]](#footnote-55) Although Russian law provides no definition of “restrictive measures”, for the sake of convenience, such measures are herein referred to as sanctions. The cpc was supplemented with two articles:

(a) Article 248.1, which establishes the “exclusive jurisdiction” of Russian State courts over disputes involving persons subject to sanctions; and,

(b) Article 248.2, which entitles such persons to seek to prevent legal proceedings from being initiated or continued in a foreign court or in international arbitration seated outside Russia, at a Russian State court.

4.1 Article 248.1 of the cpc

The new law expands the list of disputes that fall under the “exclusive jurisdiction” of Russian State courts, provided that certain conditions are met.[[56]](#footnote-56) Additionally, a person (natural or legal) is considered to be subject to sanctions in two cases: (i) when a Russian person is sanctioned directly (*e.g.* named in the US sdn list); and (ii) when a legal entity is indirectly sanctioned on the basis of it being owned or controlled by one or more sanctioned Russian persons (a Sanctioned Party). Further, a Sanctioned Party may refer a contractual dispute to a State court if:

– The legal proceedings in a foreign court or international arbitration seated outside Russia (the Foreign Forum) are not provided for by an international treaty of the Russian Federation or by jurisdiction agreement of the parties; or

– There is a jurisdiction agreement/contractual clause specifying the Foreign Forum, but this is unenforceable due to the sanctions imposed on one of the parties, thus depriving this party of its access to justice. To be noted, it is up to the court to determine how such unenforceability may be manifested.

As a general rule, already present before the new law, a violation of the exclusive jurisdiction of Russian courts constitutes a ground for refusal of recognition and enforcement of a foreign arbitral award or a court decision.[[57]](#footnote-57)

4.2 Threat of Nationalization

Western governments and companies’ reaction to the Russian invasion of Ukraine in February 2022 was very strong and swift. Followed by comprehensive sanctions being imposed, a majority of large EU and US companies publicly announced their withdrawal or suspension of operation on the Russian market. Many companies decided to close stores and stop production in factories. In response to these measures, the Russian government announced at least two different legislative proposals with the same effect, namely, to nationalize such suspended operations. In short, the legislative proposal would allow for a decision by Russian authorities to take over and continue operations, through an appointed Russian administrator. According to the proposals, there would also be an option for such an administrator to after a time period sell the company on the Russian market. These legislative proposals have not yet been adopted, but the mere discussion and threat of such a law has left many companies caught between the need to comply with EU and US sanctions, and at the same time face risking having large investments being seize and taken over in the future.

4.3 Russian Criminalization of Compliance with Unfriendly States Sanctions

Another very prominent countermeasure is the Russian proposal to criminalize the adherence to EU and US sanctions. Similar to the EU Blocking Statute, which also allows for criminal sanctions for complying with US extraterritorial export control and sanctions regimes, the Russian proposal targets compliance with sanction regimes of unfriendly states. This proposal has also caused a lot of concern as many Russian subsidiaries of EU companies, are managed locally by Russian managers. These managers would then face the potential personal criminal liability simply by following through on instructions from an EU parent company if such instructions have the purpose of applying EU sanctions in Russia.

4.4 Conclusions of the Backlash

The Russian counterreaction and countermeasures are evidently having some effect in countering EU and US sanction, at least when it comes to operations in Russia. The situation for Russian managers and employees in Russia has dramatically changed in a very a short time span of two months, i.e. from the invasion of Ukraine, and the proposal to criminalize compliance with EU and US sanctions. EU companies are now facing not only the legal difficulties in how to comply with EU and US sanctions, but also face the difficulties in not putting local managers and employees at risk when they set such policies for their Russian subsidiaries.

Furthermore, the situation has led to a large number of terminated contracts and suspended deliveries due both to voluntary suspensions and sanctions complies. Numerous lawsuits and claims will likely be presented in various fora, both Russian domestic courts as well as international arbitration. Whereas EU sanctions prohibit EU courts from granting a claim if such a claim is due to compliance with EU sanctions provision e.g. on a failure to deliver due to a sanctions prohibition, there is little protection from Russian courts granting claims in Russian courts.

5 Case Study – Risks

5.1 Case Study 1: EU Company Entering the Iranian Market – Risks of Market Restrictions, Becoming an sdn or Criminal Penalties Due to Compliance

Consider a large EU company that has global sales, including the EU and US markets. It enters the Iranian market following the opening up of business as a result of the jcpoa. The EU company enters into a large contract with an Iranian company and commits to delivering products made in the EU to Iran. There are no US connections to the EU-made products or EU company’s intended business activities, no US dollar transactions or US persons involved. Technically, US law does not have jurisdiction over the transaction.

In 2018, the US re-introduced its secondary sanctions regime, including listing the Iranian customer as an sdn. The US also reinstates the possibility of listing foreign persons and companies that deal in significant tractions with such sdn s.

By continuing trading with its customer, the EU company risks violating US secondary sanctions and faces the possible consequences including becoming listed as an sdn. Becoming a listed sdn would mean that no banks would be willing to serve the EU company, and it would be banned from the US market as US companies are in principle prohibited from trading with an sdn.

By interrupting the business relationship, the EU entity faces the risk of violating the contractual terms of the contract with the Iranian customer. Further, the EU company and its representatives face the risk of violating the prohibition to comply with US sanctions. In some EU countries the penalty for violating that prohibition is statutory criminal penalties.

At the same time, EU banks would in any event usually not accept any payments from Iran. (Thus, in practice, even if the Iranian customer were not listed, the banks would refuse.)

dw 20 August 2018

*French energy giant Total officially pulls out of Iran*

Total, France’s largest energy company, announced on Monday it was pulling out of a $4.8 billion (€4.1 billion) Iranian gas field project, after admitting it was extremely vulnerable to the threat of US penalties against those doing business with Iran.

The French group was one of three major energy companies set to help supply the state-of-the-art technology needed to tap into South Pars, the world’s largest natural gas field shared by Iran and Qatar.

However, after abandoning the 2015 Iran nuclear accord in May this year, the United States has said it will reimpose sanctions on Iran in two phases, in August and November. The second round of sanctions will target the country’s vital oil and gas sector. Any firm found doing business with Iran could risk facing serious US penalties.

Source: <www.dw.com/en/french-energy-giant-total-officially-pulls-out-of-iran/a-45150849> accessed 16 October 2021

Thus, the EU company finds itself in between two conflicting laws, and would in any event, find it impossible to find a payment mechanism for receiving payment. It is understandable that the Blocking Statute has been criticised for causing more difficulties to an already difficult situation.

5.2 Case Study 2: EU Company Entering the Russian Market – Risk of Loss of Business and Denied Access to Justice

Consider an EU company that has entered the Russian market through a long term ten year framework agreement with a Russian customer in 2012 (i.e. several years before sanctions were introduced against Russia). The EU customer sells products to the Russian company in US dollar transactions. The agreement includes an ordinary arbitration clause setting out conditions for potential arbitrations in Stockholm. The agreement also contains a regular force majeure clause, but no trade sanctions clause which would allow the parties to depart from the agreement in case sanctions are introduces which make the agreement difficult to execute.

The Russian customer is owned and controlled by a specific individual. At one point, in 2016 the US decides to list this individual as an sdn. Because the Russian company is 100 per cent owned by a US listed sdn, the Russian company is effectively also subject to the same sanctions.

The EU company faces several risks.

First, continued trade in US dollars with the Russian customer causes a US nexus. There is therefore a risk that the EU company would breach US primary sanctions. Violating primary sanctions could lead to both criminal penalties (including imprisonment and fines) and civil monetary penalties for the EU company.[[58]](#footnote-58)

The company could consider changing the currency of payment to eur. However, even if the EU company removes all US nexus, including ceasing to use US dollars, the company still faces the risk of breaching US secondary sanctions if it engages in significant transactions with the Russian customer.

Even if no US nexus exist and the transactions are not significant, the EU company still faces a risks of breaching sanctions clauses in its loan and financial agreements. Such clauses often sets out obligations beyond applicable laws. The EU company may in fact have committed to not doing any business with any company or entity on an sdn list. The EU company thus risks defaulting its loan agreements, unless it refrains from doing business with the Russian customer.

Thus, in view of these risks, the EU company may in turn choose to try to mitigate its risks by suspending or terminating the contract. However, the EU company then faces the risk that the Russian company claims a breach of contract and invokes the arbitration clause.

If the Russian company invokes the arbitration clause, it has to transfer a payment of a registration fee through a bank to the arbitration institute. However, it is very unlikely that any EU-based banks will accept payment from an sdn. It is therefore likely that the Russian company will not be able to pay the registration fee for initiating an arbitration proceeding and thus faces a form of denied access to justice. That might seem as a good thing for the EU company, but that in turn would likely back-fire.

Due to the newly implemented Russian legislation to counter the risk of denied access to justice, the Russian customer may be able to refer the contractual dispute to State courts in the Russian Federation, despite the arbitration clause. The EU company thus faces additional risks to litigate only in Russian State courts if it terminates or suspends the contract because of US sanctions, as the Russian party could claim that only Russian courts are competent to try the case.

6 Conclusions and Outlook

Because of geopolitical differences and nation states’ different foreign policy objectives, we see a departure from the multilateral framework for imposing economic sanctions in the United Nations and a clear movement towards unilateral autonomous sanctions. Especially some US sanctions causes severe implications and a great amount of uncertainty for businesses around the globe, due to their extraterritorial effects, both in law and in practice. However, the recent EU and US sanctions (as well as those from other Western countries), have also shown that we may be entering a new age of coordinated and effective sanctions.

As the cases of the Blocking Statute and Russian countermeasures illustrate, US extraterritorial sanctions also lead to a backlash and more risks for global businesses. International trade is by its nature more exposed to risk, such as currency fluctuation, cultural and political differences, and legal developments. More conflict of laws means less predictability and less deal certainty. Adding a layer of swift and unpredictable, and often conflicting sanctions regimes, will really harm global trade. As in the case of the recent sanctions against Russia and Belarus shows, most large EU and US companies will simply refrain from doing business with Russia even if it would be possible under certain provisions of the sanction’s regimes. In this senses, sanctions and the public reaction to the invasion of Ukraine, have not only harmed trade with Russia, they have close to effectively isolated Russia from trading all together with EU and US.

Looking ahead, the global trend is heading in a direction of exasperation. More countries are acting unilaterally and introducing similar regimes. In particular, China recently enacted its own form of trade sanctions and export control laws (Unreliable Entity List), Blocking Statute and now also Anti-Foreign Sanctions Law, which appear to mirror the different schemes maintained by the US and the EU.

Ultimately, companies may need to “regionalize” their operations in order to mitigate risks of being caught in the midst of new sanctions regimes or between conflicting laws. The increasing use of unilateral and autonomous sanctions, and in particular those with secondary sanctions provisions, can evidently rip up the tightly woven fabric that makes up global trade and supply chains, and provide a catalyst to the “decoupling” trend. The sanctions against Russia shows how quickly this may happen. In itself, decoupling is simply a term, and its effects will likely include less rational economic choices (local sourcing instead of competitive imports). However, more worrying is if it rips up the political and cultural fabric between nation states, which leaves nothing left to protect; we are then in for a gloomy ride reversing the positive safety net of the Bretton Woods System that once was created to prevent future world wars.

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