ALERT MEMORANDUM

In Annulment Proceedings over ICC Award, Paris Court Rules on Nature of US, EU and UN Sanctions

July 10, 2020

On June 3, 2020, the International Chamber of the Paris Court of Appeal rejected an annulment application brought against an arbitral award rendered by a Paris-seated ICC arbitration tribunal. The ICC tribunal on December 27, 2018 rendered an award in favor of the Iranian Natural Gas Storage Company ("NGSC"), in a dispute arising out of the termination of a contract for the conversion of a gas field.

The Court held that the ICC award at issue, which had allegedly failed to take into account the impact of US and international sanctions against Iran on the termination of the contract, did not violate the French conception of international public policy. The court also found that EU and UN sanctions constitute overriding mandatory rules that form part of international public policy, whereas US sanctions do not. This decision provides useful guidance on the potential impact of international sanctions on the validity and enforcement of arbitral awards.

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Background of the Dispute

In 2002, Sofregaz (now TCM FR S.A.), a French engineering company, and the National Iranian Oil Company ("NIOC") entered into a contract for the conversion into underground storage of the Yort-E-Shah gas plant, located about 70 km from Tehran. The parties chose Iranian law as the governing law of the contract and referred any dispute to arbitration under the ICC Arbitration Rules. NIOC transferred its rights under the contract to the company National Iranian Gas Company in 2004, which in turn transferred them to NGSC, an Iranian company active in the field of natural gas storage, in 2007. Upon completion of the first phase of the contract, *i.e.*, the exploration activities, the Bank of Industry and Mine refused to extend the bank guarantees (denominated in USD) required for the execution of the two subsequent phases of the contract, which consisted in developing and designing the facilities as well as supervising the construction of above-ground facilities. In June 2008, Sofregaz proposed to mutually terminate the contract and replace it with a new contract, denominated in euros, with no obligation to provide a bank guarantee. NGSC considered that Sofregaz was delaying the pursuit and completion of the project in breach of its obligations under the contract, and ultimately notified Sofregaz of the unilateral termination of the contract, in August 2008.

In 2014, following unsuccessful attempts to challenge NGSC's decision to call upon various bank guarantees before French courts, Sofregaz initiated arbitration against NGSC for wrongful termination of the contract and claimed an amount in excess of EUR 17 million. NGSC submitted counterclaims. The ICC arbitration proceedings were seated in Paris, France.

In a 2018 award, the tribunal found that the termination of the contract was justified. It found Sofregaz liable for USD 12 million in damages arising out of its contractual breaches and ordered it to pay the amount in excess of the ones already drawn by NGCS under the guarantees. The tribunal also awarded Sofregaz an amount in excess of USD 2,4 million, corresponding to an unpaid invoice and a down payment. Sofregaz filed an application to set aside the award before the Paris Court of Appeal.[1] Among reasons for setting aside the award, Sofregaz argued that the tribunal failed to carry out its mandate and did to consider the impact of international sanctions against Iran on the performance of the contract, in particular on the obligations relating to the financial guarantees, in violation of international public policy.

On June 3, 2020, the Court rejected the challenge.[2] The Court found that US economic sanctions against Iran did not form part of the French conception of international public policy, whereas United Nations ("UN")[3] and European Union ("EU")[4] sanctions did. The Court rejected Sofregaz' argument that the arbitral tribunal failed to adequately state reasons for its decision regarding the impact of the sanctions imposed against Iran, stating that the tribunal had sufficiently considered the argument, even if only implicitly, having considered that it was neither relevant nor necessary to the resolution of the dispute. Moreover, the Paris Court held that the tribunal did not violate the French conception of international public policy in doing so.

The Paris Court's finding that economic sanctions imposed against Iran by the US do not form part of international public policy, whereas economic sanctions imposed by the EU and the UN do, sheds light on an issue on which little prior guidance exists, namely, the impact of international sanctions on the validity and enforcement of international

[1] Operational since March 1, 2018, the International Chambers of the Paris Commercial Court and Paris Court of Appeal were established in order to render Paris more attractive in resolving international disputes. Proceedings before the International Chambers can be conducted in English, with the possibility of cross-examination by the parties and live testimony of witnesses and experts. It now hears all proceedings for setting aside arbitral awards rendered in international arbitrations seated in Paris.

[2] Paris Court of Appeal, Decision No. 19-07261 of June 3, 2020 (hereinafter "*Sofregaz v. NGSC*").

[3] UN Security Council Resolutions 1737 of December 23, 2006, 1747 of Mar. 24, 2007, and 1803 of March 3, 2008.

[4] EU Council Regulations (EC) No. 423/2007 of April 19, 2007, (EU) No 961/2010 of October 25, 2010, and (EU) No. 267/2012 of March 23, 2012 concerning restrictive measures against Iran.

arbitral awards in France. This decision provides insight on whether French courts consider economic sanctions enacted by foreign countries or international organizations as forming part of the French conception of international public policy.

The Legal Framework Applicable in France to International Sanctions

Under EU law, Member States' domestic courts may give effect to mandatory rules (such as extraterritorial sanctions) of a State other than the State of the forum and/or applicable law.[5] Domestic courts may also disregard the sanction under consideration, except if the sanction forms part of international public policy. There are significant differences in the treatment by French courts of US sanctions compared to sanctions enacted by the EU or the UN.

Sanctions enacted by US authorities

US sanctions may be extra-territorial in scope. In addition to the current economic sanctions imposed on Iran, the US has previously enacted extraterritorial sanctions, such as the US embargo against the Soviet Union following the Soviet intervention in Afghanistan, which was intended to apply to European subsidiaries of US companies. As early as 1979, subsidiaries of US banks established outside the territory of the US were ordered to freeze Iranian assets.

The EU generally opposes the extra-territorial application of US Sanctions. In 1996, the EU adopted a blocking regulation[6] to protect citizens and companies from the effects of the US Amado-Kennedy Act, which banned all oil investments in Iran and Libya and subjected any company from any country that violated this ban to sanctions, and the Helms Burton Act against Cuba.[7] This regulation was updated in 2018 to include the new US extraterritorial sanctions against Iran (the EU "Blocking Regulation").[8] It applies to EU persons even in cases where such EU persons have entered into contracts governed by non-EU member state laws. Enforcement of the Blocking Regulation falls within the competence of EU Member States.

Up until today, France has not applied penalties for violations of the Blocking Regulation, whereas other Member States impose civil, administrative or even criminal penalties in case of such violations.[9] Nevertheless, the Paris Court has traditionally viewed US attempts to give extraterritorial effect to their economic sanctions unfavourably. In the *Fruehauf* case, the Paris Court of Appeal compelled the subsidiary of a US company, through the appointment of a temporary administrator, to execute a supply contract with the People's Republic of China notwithstanding the order issued by the US Treasury Department requiring Fruehauf to suspend performance of the contract on the basis of non-compliance with the US Transactions Control Regulations.[10]

On June 26, 2019, a parliamentary report by French MP Raphael Gauvin also proposed using the French Blocking Statute of 1968, which aims at limiting foreign discovery with respect to information located in the French territory, as a tool to limit the extraterritorial reach of US sanctions within the EU territory. The Report recommended modernizing the EU Blocking Regulation to extend the protection

[5] Rome Convention on the law applicable to contractual obligations, art. 7(1); Regulation (EC) No. 593/2008 of the European Parliament and of the Council of June 17, 2008 on the law applicable to contractual obligations (Rome I), art. 9(3). *See also* Cour de cassation, Decision No. 08-21511 of March 16, 2010, *Moller Maersk Company v. Viol Company and Fauveder Company*.

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

[7] *See* Cleary Gottlieb's alert memorandum on the end of suspension of title III of Helms-Burton available here: https://www.clearygottlieb.com/-/media/files/alert-memos-2019/2019_04_19-end-of-suspension-of-title-iii-of-the-helms-burton-act-pdf.pdf.

[8] Commission implementing Regulation (EU) 2018/1101 of August 3, 2018 laying down the criteria for the application of the second paragraph of Article 5 of Council Regulation (EC) No. 2271/96.

[9] Member States (including the UK, Sweden and the Netherlands) impose criminal penalties for violations; other Member States impose civil/administrative penalties (including Germany, Austria, Spain and Italy).

[10] Paris Court of Appeal, May 22, 1965, *Sté Fruehauf Corp. c. Massardy et a.*, JCP G 1965, II, 14274 bis, concl. Neveu.

offered by the French Blocking Statute to the entire EU territory.[11]

Sanctions enacted by the European Union or the United Nations

In recent years, the EU has frequently imposed sanctions and other restrictive measures either on an autonomous basis or by implementing binding Resolutions of the UN Security Council. Contrary to international sanctions imposed by third-countries, restrictive measures imposed by the EU through Regulations are binding and directly applicable throughout the EU.[12] Consequently, judges and arbitrators are required to give effect to any applicable sanction in their decision-making process.

Arbitral institutions including the ICC, LCIA and SCC stated in a common opinion on the potential impact of the EU sanctions against Russia on international arbitration administered by EU-based institutions, that where sanctions have an effect on the substance of disputes, "the dispute itself will be affected by the sanction, i.e. from the perspective of the arbitral institution, the sanction will bite, irrespective of where the arbitration is seated, which EU arbitral institution is administering it, the law(s) applicable to it, and where any award is ultimately sought to be enforced. As such, moving the seat of these arbitrations outside of the EU will not make any difference, if the dispute is subject to the sanctions regime."[13]

Are International Sanctions Part of the French Conception of International Public Policy?

The decision by the Paris Court of Appeal sheds light on the relationship between economic sanctions and international arbitration, in particular regarding the treatment of awards touching upon issues relating to international sanctions, including non-performance.

In its application, Sofregaz argued that the arbitral tribunal did not consider the international sanctions imposed against Iran when deciding whether the termination of the contract was wrongful. According to Sofregaz, the award was contrary to international public policy because the tribunal failed to adequately state reasons for its decision regarding the impact of the sanctions imposed against Iran.

In order to decide whether giving effect to a contract allegedly subject to international sanctions was contrary to the French conception of international public policy, the Court first recalled that, in order to set aside an arbitral award on the basis of international public policy, the violation needed to be "effective and concrete."[14]

Concerning the sanctions imposed against Iran by the US, the Paris Court ruled that while the sanctions amounted to foreign mandatory rules, they could not be integrated into international public policy, notably because they "[could] not be regarded as an expression of international consensus" due to past EU and French opposition to their extraterritorial reach.[15]

The Paris Court reached the opposite conclusion regarding sanctions enacted by the EU and the UN. According to the Court, these measures aimed at contributing to the maintenance or restoration of international peace and security, and were as a consequence to be considered as French mandatory rules fully integrated into the French conception of international public policy. This is to our knowledge the first decision in which the Paris Court reached such a conclusion in the context of annulment proceedings,[16] which will have potentially significant consequences on the enforcement of arbitral awards in France and the validity of awards issued by French-seated arbitral tribunals.

[11] R. Gauvain, "Rétablir la souveraineté de la France et de l'Europe et protéger nos entreprises des lois et mesures à portée extraterritoriale", Report submitted to Prime Minister Edouard Phillipe, June 26, 2019, pp. 80 *et seq*.

[12] *See* Council of the European Union, Guidelines on implementation and evaluation of restrictive measures (sanctions) in the framework of the EU Common Foreign and Security Policy, ¶ 7.

[13] Common Opinion by the ICC, LCIA and SCC, The potential impact of the EU sanctions against Russia on international arbitration administered by EU-based institutions (June 17, 2015), p. 5.

[14] *Sofregaz v. NGSC*, ¶ 50.

[15] *Sofregaz v. NGSC*, ¶¶ 61-63.

[16] *See*, in the context of contract litigation, Paris Court of Appeal, Decision No. 12/23757 of February 25, 2015.

Taking a step back, arbitral tribunals can take two different approaches to sanction regimes when determining their effect as a matter of private law: (i) a legal approach or (ii) a fact-based approach.[17]

Pursuant to the first approach, tribunals may treat the sanction as part of the legal framework applicable to the arbitration, *i.e.*, the applicable law and/or overriding mandatory rules forming part of international public policy. Here, the Paris Court held that US sanctions do not constitute overriding mandatory rules part of the French conception of international public policy that would excuse non-performance even though they are foreign to the applicable law, whereas EU and UN sanctions do.

Depending on the circumstances of each case, a party could in any event plead that an applicable sanction made it, in practice, impossible or illegal to execute the contract because of the risk of penalties or enforcement measures.[18] Pursuant to this second approach (the so-called *datum* or "sanction as fact" approach), arbitral tribunals could therefore treat US sanctions as part of the factual circumstances bearing on the party's ability to perform the contract.[19]

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[17] C. Moore, M. Molfa and A. Grant, "Sanctions and arbitration", IBA Arbitration Committee newsletter (September 2019).

[18] *Ibid*.

[19] In the case at hand, this second approach did not come into play in light of the Court's conclusion that the moving party had not proven that the US sanctions made it impossible to execute the contract, in light of Sofregaz' failure to perform obligations other than those relating to the financial guarantees.