Iranian Ministry of Defence unable to enforce interest component of arbitration award (Ministry of Defence and Support for Armed Forces of the Islamic Republic of Iran v International Military Services)

02/08/2019

Arbitration analysis: Robert Meade, senior associate at Bracewell, examines the High Court's decision in Ministry of Defence and Support for Armed Forces of the Islamic Republic of Iran v International Military Services Ltd that, after an arbitration award was made in favour of the claimant, Iranian Ministry of Defence, the defendant, English arms supplier, was not liable for post-award interest accruing during the period that the claimant was designated as a sanctioned entity under EU sanctions against Iran.

Ministry of Defence and Support for Armed Forces of the Islamic Republic of Iran v International Military Services Ltd [2019] EWHC 1994 (Comm)

What are the practical implications of the judgment?

The increasing use of international financial sanctions over the last decade or so, and in particular so-called 'sectoral sanctions' which often target the energy sector, has imposed an increased compliance burden on businesses operating internationally. However, there have been very few instances of these sanctions being considered by the courts. This has resulted in a lack of certainty over how the sanctions will be applied.

This judgment is notable as it demonstrates how certain aspects of the EU sanctions against Iran will be applied by the English courts. It answers a discrete question that turns on the proper interpretation of Articles 38 and 42(1) of Regulation (EU) 267/2012, the instrument imposing sanctions on Iran. That question concerns the effect of EU sanctions on the accrual of post-arbitral award interest. Articles 38 and 42(1) of Regulation (EU) 267/2012 are materially similar to those found in the EU Regulations imposing other sanctions regimes and they are not limited to claims for post-award interest. This means the judgment is likely to have wider significance.

In the absence of judicial interpretation of the EU sanctions, practitioners have often turned to the guidance provided by national sanctions authorities (such as the UK's Office of Financial Sanctions Implementation). That guidance is stated to be non-binding, which has resulted in uncertainty and may have led to a cautious approach being adopted by those advising on EU sanctions. This judgment should be welcomed as providing some certainty over how Articles 38 and 42(1) of Regulation (EU) 267/2012, and the materially similar provisions applicable to other EU sanctions regimes, will be applied by the English courts.

Caution should, however, be exercised. The judgment illustrates the English courts' approach to interpreting the provisions of EU Regulations. It makes clear that both the language and the purpose must be considered and the principle of proportionality applied. The fact that other EU Regulations in respect of other sanctions regimes might contain similar or identical language does not automatically mean that they will be interpreted in the same way.

It is also important to remember that this is an English court decision that interprets and applies the articles of a specific EU Regulation. How the courts of other EU Member States would interpret those articles and the relevance of the judgment following the UK's exit from the EU and the development of its own sanctions regimes (assuming that does in fact occur) remains to be seen.

What was the background?

The defendant was an English company owned by the UK Ministry of Defence and HM Treasury. In the 1970s, it entered two contracts to supply Chieftain tanks and armoured recovery vehicles to the claimant. The deal was reportedly worth £650m and the claimant paid in advance.

The contracts were terminated in February 1979, following the Iranian revolution. Only a fraction of the promised number of tanks had been delivered by that time, and two International Chamber of Commerce (ICC) arbitrations followed.

Final awards were rendered in both arbitrations in May 2001. The arbitral tribunal found that the defendant was liable to pay the claimant an amount in excess of £15m, plus interest at LIBOR rate + 0.5% from 28 July 1984 until payment. The claimant sought enforcement of the awards in the English court, but the enforcement process was delayed for a number of reasons.

With effect from 24 June 2008, the claimant was added to the list of designated entities subject to the EU sanctions imposed against Iran. It remains on that list. This means that the sums due to the claimant under the awards cannot be paid to it.

The question for the High Court was whether the claimant was entitled to post-award interest during the period that it was a designated entity under the EU sanctions. This required the court to construe the correct meaning and application of Articles 38 and 42(1) of Regulation (EU) 267/2012.

What did the court decide?

Phillips J concluded that the claimant was not entitled to interest during the sanctions period.

Phillips J first set out the principles governing the interpretation of EU Regulations. He noted that the court had to look at the language and the purpose of their provisions and that they had to be interpreted in accordance with the principle of proportionality.

Applying those principles to Article 38 of Regulation (EU) 267/2012, Phillips J found that both the language and the purpose of that provision supported a meaning that the award of interest could not be enforced in respect of the period that the claimant was a sanctioned entity. In particular, he found that the broadly drafted definitions of 'claim' and 'transaction' in Regulation (EU) 267/2012 supported this interpretation and that both the specific purpose of Article 38 of Regulation (EU) 267/2012 and the purpose of Regulation (EU) 267/2012 as a whole was consistent with it.

Phillips J's conclusions on the application of Article 38 of Regulation (EU) 267/2012 were dispositive of the issues in this case. He nevertheless addressed Article 42(1) of Regulation (EU) 267/2012. He concluded that it must be construed narrowly, confining its application 'to cases of incorrect but non-negligent actions taken in good faith by reference to the sanctions regime'. Article 42(1) of Regulation (EU) 267/2012 would not, therefore, apply in circumstances where the relevant liability (in this case, the non-payment of post-award interest accruing during the sanctions period) arose from the defendant's proper application of Regulation (EU) 267/2012.

Phillips J accepted that it would be a bizarre consequence of the narrow interpretation of Article 42(1) of Regulation (EU) 267/2012 if it provided protection where Regulation (EU) 267/2012 had been mistakenly applied but not where it had been properly applied. However, he was not persuaded that would be the result as he considered Article 38 of Regulation (EU) 267/2012 would provide protection in respect of liability arising from the proper application of Regulation (EU) 267/2012.

Do you expect that the issue underlying this case is likely to affect many arbitrations?

Although neither as extensive, nor numerous as their US counterparts, EU sanctions are increasingly being imposed. It is an ever-changing area of law, with its course being determined by geo-politics. The penalties for violation of the sanctions can be severe and compliance is high as a result. Contracts will continue to be suspended or terminated and funds and economic resources will continue to be frozen following the introduction of further sanctions. This may lead to claims (in litigation or arbitration depending on the situation) and Articles 38 and 42(1) of Regulation (EU) 267/2012, and similar articles in other EU Regulations, might be called on in defence. In those circumstances, the judgment is likely to provide useful guidance and, potentially, precedent.

The judgment does not consider whether the enforcement of the arbitral awards in question would be contrary to public policy, permitting enforcement to be refused under section 103(3) of the Arbitration Act 1996. Questions of the

enforcement of arbitral awards and public policy are likely to affect many arbitrations where there is a sanctions touch-point.

Are there any steps that parties can take in an attempt to avoid this sort of outcome?

Any contractual term that contradicts the operative provisions of the EU sanctions or undermines their purpose will likely be unenforceable on the grounds of illegality.

However, express provisions can be included in contracts detailing what should happen and where liability should lie in the event that the operation of sanctions affect the transaction. Such provisions might be included within a force majeure clause. By providing a contractual defence to non-performance they would remove the need to rely on the defences contained in the EU Regulations themselves.

Robert Meade acts on energy related international arbitrations and advises clients on sanctions related issues. He was recognised as a 'Rising Star' in Legal 500's 2019 International Arbitration Powerlist—United Kingdom and described as 'one of the most promising young counsel on the London scene'. Bracewell LLP is a leading law firm serving the oil and gas, power, financial services, technology and public finance industries throughout the world. Its London office is exclusively dedicated to energy sector transactions, projects and disputes.

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