

SUBSTANTIVE PROTECTION OF FOREIGN INVESTMENTS IN SANCTIONS-RELATED DISPUTES

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Introduction

Sanctions of the European Union (EU) freeze the funds and assets of foreign investors in many ways. Banks block accounts, shares cannot be sold, counterparties evade their obligations by invoking the no-claims and no-liability provisions of the sanctions legislation. On our estimate, the sanctions-related claims of Russian investors against EU counterparties along with the assets frozen in the EU run into tens or possibly hundreds of billions of US dollars. Challenging sanctions directly is not always an effective remedy. In *Fridman v Council*, the EU General Court annulled Mikhail Fridman's listing, but the Council of the EU simply redesignated him. In *Tokareva v Council*, the latter reinstated the designation after several successful challenges, until the EU General Court finally held that this conduct harmed the EU legal order.

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Investment arbitration offers a way out. The investor sues the state in a neutral forum, under international law rather than the law of the state that imposed the sanctions, and seeks substantive compensation (several hundred million US dollars on average). The merits of the claim are straightforward: the state promised foreign investors certain level of treatment in an investment treaty, sanctions negate the benefit investors had under this treaty, so the state must pay for the losses caused by this.

Sanctions and Treaty Obligations

The starting point for seeking compensation is whether sanctions take priority over obligations states assume under investment treaties. Respondent states may argue that they should be excused for non-performance of their international obligations, as they are obliged to apply their own sanctions. However, Article 27 of the 1969 Vienna Convention on the Law of Treaties provides that states cannot invoke their domestic law as justification for their failure to perform obligations.

This applies equally to cases where the EU Member States implement the EU sanctions. The Member States must be responsible for those sanctions based on Article 1 of the Articles on Responsibility of States for Internationally Wrongful Acts. The implications of the EU sanctions adverse to foreign investors are therefore attributable to the Member States, alongside the EU. Moreover, in *Bank Melli v Bahrain*, the investment tribunal explicitly held that national sanctions lack the universality of the United Nations Security Council resolutions, form no part of transnational public policy, and bind only persons subject to the jurisdiction of the authority that imposed them. Accordingly, respondent states may violate their obligations under investment treaties by imposing sanctions.

Standards of Investment Protection Violated by Sanctions

Sanctions can breach several provisions of the investment treaties at once, and claimants ordinarily plead them together to obtain compensation.

The fair and equitable treatment (FET) provision is the broadest one. In *Tecmed v Mexico*, the tribunal identified its elements as consistency, clarity, transparency and the absence of arbitrariness. These requirements concern how a state applies its law rather than what the law says. The content of sanctions therefore does not violate FET. Sanctions violate FET because of the way they are imposed and applied. For example, in *Nord Stream 2 AG v The European Union*, the claimant argues that the EU amended the applicable regulatory framework so as to target a specific investment.

Sanctions may also violate the full protection and security (FPS) provision. Usually, FPS is interpreted as covering only the physical protection. Some tribunals go beyond this approach and hold that FPS can also provide legal security. For example, in *Siemens v Argentina*, the tribunal described legal security as clarity in

applicable rules and foreseeability in their application. The *Frontier Petroleum v The Czech Republic* tribunal explained the difference between FET and FPS: the latter requires the state to provide a legal framework that protects the investment, while the former requires it to refrain from unfair conduct. Accordingly, sanctions that are both harmful to foreign investments and arbitrarily applied violate both FET and FPS.

Where sanctions are built around a particular asset, violations of the non-discrimination provisions can also be pleaded. The national treatment standard requires that foreign investors must be treated no less favourably than domestic ones in comparable circumstances. Most favoured nation treatment requires the same but by comparison with investors from third states. That is the claimant's situation in the already referenced *Nord Stream 2 AG* case, where comparable assets were exempted from the amending Directive, while the claimant's assets were not.

The free transfer provision is much narrower in its scope. As its name suggests, it protects the transfers flow related to foreign investments. In *Continental Casualty v Argentina*, it was held that the protected transfers are the ones essential for, or typical to the making, controlling, maintenance, disposition of investments. The *Karkey v Pakistan* tribunal also extended the scope of free transfer to the movement of investment-related assets generally. Since sanctions prevent that movement entirely, they violate investment treaties and give rise to the investors' right to compensation.

The strongest ground to plead is unlawful expropriation. Direct expropriation is now rare, since states try to seize assets indirectly. Accordingly, in sanctions-related investment disputes, the most relevant form of expropriation is indirect expropriation. In *Metalclad v Mexico*, the tribunal established the test for indirect expropriation as deprivation, in whole or in significant part, of the economic benefit from the property. The length of the interference is what decides the lawfulness of the expropriation. For example, the *Wena Hotels v Egypt* tribunal treated a year of interference with the asset as indirect expropriation. Asset freezing and external administration imposed under the sanctions legislation last for an indefinite period, so they most certainly can constitute indirect expropriation, as they deprive foreign investors of economic benefits from their investments indefinitely.

The Police Powers Defence

The main defence of respondent states is that they were exercising their police powers by imposing sanctions. However, this defence is not an absolute one. In *Certain Iranian Assets*, the International Court of Justice applied a proportionality test: whether the measure pursues a legitimate public purpose, whether an appropriate correlation exists between that purpose and the measure in question, and whether the adverse impact is manifestly excessive.

The tribunal in the Bank Melli case applied that approach to external administration imposed based on sanctions and held that it was a political retaliation. A designation founded on family connection, as in *Fridman v Canada*, or reinstated after annulment, as in *Tokareva v Council*, is therefore hard to justify under that test. Respondent states must properly substantiate that their sanctions are proportionate rather than simply assert their alleged public purpose.

Enforcement

The July 2025 18th EU sanctions package prohibited the enforcement of Russian sanctions-related investment awards within the EU. Nevertheless, claimants aggrieved by sanctions can enforce awards outside the EU, in jurisdictions that have not adopted the EU sanctions and honour the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards and the 1965 Convention on the Settlement of Investment Disputes between States and Nationals of Other States.

Conclusion

Investment arbitration is an effective mechanism for obtaining compensation for losses caused by sanctions. Respondent states are bound by their investment treaties, and they cannot use sanctions as an excuse for non-performance of international obligations. A state that promised foreign investors specific treatment cannot escape that promise by invoking its police powers, because they protect genuine regulations and not measures adopted for political ends.

