ASSESSING AND MANAGING THE IMPACT OF ECONOMIC SANCTIONS ON COMMERCIAL CONTRACTS

This article considers to what extent under the law of England and Wales economic sanctions which do not contain an applicable "grandfathering clause" (permitting the performance of pre-existing contracts) can be said to end, rather than suspend, existing contractual arrangements. This article does not directly consider export controls or counter-terrorist financing measures, although some of the considerations set out within will be relevant to those too.

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RESOURCE INFORMATION

RESOURCE ID

8-584-8145

RESOURCE TYPE

Article

JURISDICTION

England, Wales

The UK government describes sanctions and embargoes as political trade restrictions put in place against target countries with the aim of maintaining or restoring international peace and security (Department for Business, Innovation and Skills and Export Control Organisation: Sanctions, embargoes and restrictions). Recent years have seen a welter of targeted trade sanctions resulting from instability in the Middle East, North Africa and the former CIS.

Sanctions usually extend to entities controlled by persons (real and legal) resident in the target country, even if those entities are incorporated elsewhere.

In practice, sanctions can prove a real headache for industry and commerce alike by interfering with existing or pending contractual arrangements. Their violation can have serious economic and reputational repercussions, and can even lead to prison terms. Further, it may not be possible to enforce rights relating to acts (such as transfers of money) carried out in breach of a sanction, because such acts are illegal (see, for example *Al-Kishtani v Shanshal [2001] EWCA Civ 264*).

This article considers to what extent under the law of England and Wales financial sanctions can be said to end (rather than suspend) contractual arrangements by:

- Invoking the doctrine of frustration.
- Relying on supervening illegality.
- Relying on a force majeure clause.

COMMON SANCTIONS

The most frequently applied measures are:

- Embargoes on exporting or supplying arms and associated technical assistance, training and financing.
- A ban on exporting equipment that might be used for internal repression.
- Travel bans on named individuals.
- Bans on imports of raw materials or goods from the sanctions target.
- Financial sanctions on individuals in government, government bodies and associated companies, or terrorist groups and individuals associated with those groups, almost invariably including asset freezing measures.

See further *Sanctions, embargoes and restrictions*

SANCTIONS REGIME IN UK

The sanctions regime in the UK derives from:

- EU regulations which implement sanctions and are directly effective in the UK.
- Statutory instruments which enforce the EU regulations and UN Security Council resolutions by introducing penalties.

Directions issued by HM Treasury pursuant to UK anti-terrorism legislation (see *Practice note, Counter-Terrorism Act 2008: HM Treasury's Schedule 7 regime*).

HM Treasury is responsible for implementing and administering financial sanctions in the UK, regardless of their source, while HM Revenue and Customs is the enforcing agency.

It is essential to read the relevant instruments meticulously. Sanctions usually target funds and "economic resources", the latter describing assets of every kind, tangible or intangible, movable or immovable, which are not funds themselves but can be used to obtain funds, goods or services (see *HM Treasury: Financial sanctions: frequently asked questions (August 2013)*). However, if politically or otherwise expedient, governments may institute a narrower regime than one targeting economic resources. For example, the sanctions targeted against

Russian entities which became effective on 1 August 2014 are far more tightly conscribed.

All persons (regardless of nationality or place of incorporation) within the jurisdiction must comply with the sanctions regimes in force in the UK. British nationals and entities incorporated in the UK must also comply.

Technically, UK regulation generally respects the corporate veil such that subsidiaries of UK companies which are both incorporated and operate outside the jurisdiction do not have to comply with UK sanctions (although they may have to comply with local and other sanctions regimes). However, in practice, problems will arise if the subsidiary has British (or European) directors, and money-laundering issues will arise from remitting funds to the UK (or Europe).

In many cases, HM Treasury can issue a licence exempting certain transactions from an asset freeze, although if the relevant sanction is pursuant to an UN or EU regime the licence must fall within an exemption set out in the relevant UN Security Council resolution or EU Regulation.

Licences can be:

- General and apply to anyone complying with the descriptions in the licence.
- Specific to named parties.

The former are published on the UK government website but the latter are not usually published.

For a more detailed overview of the UK financial sanctions regime, see *Practice note, UK financial sanctions regime: an overview*.

FRUSTRATION OF CONTRACTS

The essential elements of the doctrine of frustration are as follows:

- Frustration occurs:

"whenever the law recognises that without default of either party a contractual obligation has become incapable of being performed because the circumstances in which performance is called for would render it a thing radically different from that which was undertaken by the contract. Non haec in foedera veni; "It was not this that I promised to do." (*Davis Contractors Limited v Fareham Urban District Council [1956] AC 696 (Lord Radcliffe at page 729*).

- The application of the doctrine requires a:

"multi-factorial approach. Among the factors which have to be considered are the terms of the contract itself, its matrix or context, the parties' knowledge, expectations, assumptions and contemplations, in particular as to risk, as at the time of contract, at any rate so far as these can be ascribed mutually and objectively, and then the nature of the supervening event, and the parties' reasonable and objectively ascertainable calculations as to the possibilities of future performance in the new circumstances." (*Edwinton Commercial Corp v Tsavliris Russ (Worldwide Salvage and Towage) Limited (The Sea Angel) [2007] EWCA Civ 547 (Rix LJ at paragraph 111*).

The doctrine is "to give effect to the demands of justice but not to be lightly invoked" (*J Lauritzen AS v Wijsmuller BV (The Super Servant Two) [1990] 1 Lloyd's Rep 1 (Lord Bingham at page 8)*).

(See further *Melli Bank v Holbud [2013] EWHC 1506 (Comm) (Robin Knowles QC at paragraph 15)*.)

Once a contract is frustrated, that remains the case regardless of the fact that performance unexpectedly becomes possible again, even during the original period for performance: "Commercial men must be entitled to act on reasonable commercial probabilities at the time when they are called upon to make up their minds." (*National Carriers Limited v Panalpina (Northern) Limited [1981] AC 675 (Lord Simon at page 706*) citing *Scrutton J Embiricos v Sydney Reif and Co [1914] 3 KB 45 (at page 54)*; see also *Treitel, Frustration and Force Majeure (Sweet and Maxwell, 3rd ed, 2014) paragraphs 9-002-9-003*. "What we know has in fact happened is, however, available as an aid to determine the reasonable probabilities at the time when decision was called for."(*National Carriers (Lord Simon at page 706*) citing Lord Wright in *Denny, Mott and Dickson Limited v James B Fraser and Co Limited [1944] AC at pages 265, 277, 278*).

Depending on the circumstances, it may be possible to form a reasonable view as to the possibility of performance very soon after the occurrence of a potentially relevant event. For example, the House of Lords in *Fibrosa Spolka Akcyjna v Fairbairn Lawson Combe Barbour Limited [1943] AC 32* held that the outbreak of war between England and Germany frustrated a contract of sale (to an entity in German occupied territory) that incorporated a clause which read:

"Should dispatch be hindered or delayed ... by any cause whatsoever beyond our reasonable control, including ... war ... a reasonable extension of time shall be granted", because the war "manifestly and inevitably brought about" a "prolonged and indefinite interruption of prompt contractual performance" (Lord Simon at page 40.)

However, in other circumstances it will be necessary to wait a period. There is a consistent line of authorities stretching back 100 years which evidences that the courts are slow to be persuaded that sanctions have released parties from their obligations on grounds of frustration. For example, in *Miller Limited v Taylor [1916] 1 KB 402*, the Court of Appeal held that a contract for export of confectionary was not frustrated by an embargo imposed on the export of such goods at the outbreak of the First World War, because the embargo was withdrawn 15 days after it was made and before the end of the normal delivery period. In that case, Warrington LJ distinguished between illegality arising from:

- A state of war (trading with the enemy), which "the Courts have always treated ... as a state the duration of which it is impossible to foresee; the duration depends not on the will of the Government of this country, but on a number of other considerations all of which are as uncertain as any such considerations can be".
- "an act of the Executive Government, such as the imposition of an embargo or the imposition of a prohibition" (at paragraph 416.)

Treitel also suggests that the decision can, perhaps, be explained on the ground that the sellers acted with undue precipitation (quoting *Atlantic Maritime Co Inc v Gibbon [1954] 1 QB 88 at page 114*) by claiming to be discharged very soon after the announcement of the embargo (*Treitel, paragraph 9-006*; see also *paragraphs 5-051* and *8-034*).

Similarly, in *Libyan Arab Foreign Bank v Bankers Trust Co [1989] 1 QB 728*, a case concerning a US sanction which was said to frustrate an English law contract, Staughton J found that a presidential order freezing Libyan assets did not frustrate LAFB's contract with its correspondent US bank, stating that "in my judgment ... the obligation of Bankers Trust was suspended but not discharged" (at paragraph 772 B-C).

Even if sanctions might frustrate a contract where they make performance impossible, they will not do so where it can be shown that a licence could be sought and could be expected to be forthcoming (see, for example, *DVB Bank SE and others v Shere Shipping Co Limited and others [2013] EWHC 2321 (Comm)*; *Melli Bank v Holbud [2013] EWHC 1506 (Comm)*.)

It seems likely that to successfully argue a sanction had frustrated a contract it would be necessary to show that no licence could in any event be obtained, or that despite the use of best endeavours the licence was unobtainable (see *DVB Bank at paragraphs 43-49 and 81*; and the cases cited therein). In most circumstances, it is unlikely that a party will be able to do this immediately on the coming into force of a sanction. However, it remains to be seen how, where no licence has in fact been granted (whether or not it might have been if applied for in time), a judgment for breach of contract which requires the payment of sums to a person subject to restrictions by reason of the sanctions regime interacts with criminal law since, if the contract had been performed, a criminal offence would most probably have been committed.

Finally, the ability of a party to perform part of the contract may mean that the contract is not frustrated. The degree of performance possible must be assessed. For example, in *Islamic Republic of Iran Shipping Lines v Steamship Mutual Underwriting Association (Bermuda) Limited [2010] EWHC 2661 (Comm)*, a licence issued by HM Treasury empowered the defendant P and I Club "to continue to provide [the claimant shipping line] with insurance cover in respect of the risks insured by reason of the provisions of the Bunkers Convention". The defendant subsequently terminated the claimant's insurance, which was for a wide range of risks, on the ground of frustration or supervening illegality. Beatson J held that the defendant was wrong to do so, "[A]lthough the scope of cover is significantly narrower than it was before ... its nature is not different, it remains indemnity insurance" (at paragraph 115).

However, if the inability to obtain a licence renders an obligation incapable of being performed indefinitely due to the existence of sanctions, the result is likely to be that a supervening event has significantly changed the nature of the contractual obligations. In those circumstances, the contract may well be frustrated.

For the effects of frustration on a contract, see *Practice note, Contracts: frustration.*

CONTRACTUAL TERMS RELATING TO SANCTIONS

It is possible to legislate in a contract for an event, thereby preventing the doctrine of frustration from applying if that event occurs. Such provision might take the form of:

- An express term that covers the relevant event.
- A term that demonstrates that the parties contemplated the event and allocated the risk that it would occur.

While such terms will not deprive the relevant sanctions of effect, they seek to address their consequences (for example, by providing for the suspension or termination of obligations, or alternative performance). Of course, the provisions of the contract that deal with the consequence will themselves be subject to the sanctions, for example, any terms which provide for the repayment of deposits might be subject to asset freezes.

By way of illustration, it is not unusual make a contract "subject to licence" in order to account for the possibility that a licence will be required in order to render performance legal. These words appear not to prevent the formation of a contract, but mean that there is a condition that a licence must be obtained and neither party is to be liable under the contract unless a licence is obtained (*Treitel, paragraphs 8-016*; *Windschuegl Limited v Pickering and Co Limited [1950] 80 L.I.L Rep 89 page 92*).

Alternatively, a contract might include an express (or, indeed, implied) term stipulating alternative, legal modes of performance if a sanction is imposed. For example, in Libyan Arab Foreign Bank the claimant Libyan bank succeeded in its claim for breach of contract against the UK branch of a US bank which, pursuant to blocking orders issued by the US government against Libya in January 1986, withdrew its US dollar deposit account. In that case, the contract (governed by English law) could be performed in several ways, one of which would not involve an illegal act in a foreign country (the defendant could deliver the amounts sought by the claimant in cash sterling or bank account transfer in the UK, which would not have involved an illegal act in the US). The legal mode of performance was impliedly permissible where there was no express term excluding it, but equally it could have been contractually provided for.

FORCE MAJEURE

More commonly, a contract will include a ***force majeure*** clause. These are designed to allow one or both parties to cancel a contract, or otherwise be excused from performance either temporarily or permanently, on the happening of specified events or events beyond the party's (or parties') control. Force majeure is not a term of art in English law and its meaning will vary by reference to the instrument in which it appears. The burden of proving that an event falls within such a clause falls on the party relying on it who must also prove that non-performance of an obligation was due to that event.

There is precedent to support the contention that economic sanctions fall within the expression "force majeure". In *Lebeaupin v Crispin [1920] 2 KB 714*, McCardie J observed (obiter) that the phrase: "was not interchangeable with 'vis major' or 'the act of God'. It goes beyond the latter phrases. Any direct legislative or administrative interference would of course come within the term: for example an embargo" (at pages 719-720).

However, the cases demonstrate that, for a force majeure clause to be effective (at least one in usual terms relating to events "beyond the control of the relevant party"), the party relying on it must show that there were no reasonable steps that he could have taken to avoid or mitigate the event or its consequences (see *Chitty on Contracts 1st supplement, (Sweet and Maxwell, 31st ed, 2013) paragraphs 14-143)* and the cases cited in footnote 644 to that paragraph, especially the judgment of Kerr LJ in *B and F Contracts and Designs Limited v Victor Green Publications Limited [1984] ICR 419*. For example, the Court of Appeal said in *Channel Island Ferries Limited v Sealink UK Limited [1988] 1 Lloyd's Rep 323* "a party must not only bring himself within the clause but must show that he has taken all reasonable steps to avoid its operation, or mitigate its results" at page 327 (see also at pages 328-329 (Ralph Gibson LJ). Accordingly, thought should be given to the impact of any licensing regime when drafting or seeking to rely on such a clause.

Nonetheless, force majeure clauses tend to be strictly construed by the courts and it is prudent to expressly include reference to sanctions if it is intended that they should be covered by such a clause. Given their potential impact on a party's obligations to perform, and liability for any failures to perform, force majeure clauses may also be subject to Unfair Contract Terms Act 1977 (UCTA) and (if relevant) the consumer protection legislation. It is noteworthy that the courts have refused, on public policy grounds, to give effect to clauses that expressly deal with supervening illegality when the illegality involved is trading with the enemy (see *Ertel Bieber Co v Rio Tinto Co Limited [1918] AC 260* and the discussion in *Treitel, paragraphs 8-057 to 8-058)*.

GETTING IT WRONG, AND AVOIDING LIABILITY ANYWAY

EU Regulations which impose sanctions now generally include a provision which provides that the:

"refusal to make funds or economic resources available, carried out in good faith on the basis that such action is in accordance with the Regulation, shall not give rise to liability of any kind on the part of the natural or legal person or entity implementing it, or its directors or employees, unless it is proved that the funds and economic resources were frozen as a result of negligence".

This may provide a defence to liability for breach of contract.

In *Soeximex SAS v Agrocorp International PTE Limited [2011] EWHC 2743 (Comm)* the claimant buyer entered into a contract to buy Burmese rice from the defendant. Payment was to be by way of an irrevocable letter of credit. The buyer failed to open such a letter and the sellers treated that fact as repudiatory breach and sued for damages. The buyer failed to demonstrate that performance of the contract would have been illegal but, as a fall-back, relied on Article 14 of the relevant Regulation which was in the terms set out above. The contract contained a GAFTA arbitration clause and so the court was not required to decide whether this defence succeeded. Nonetheless, Gloster J, on an application to remit the matter to the board for reconsideration, found that there was:

"certainly a reasonable argument on the basis of the wording of Article 14 to the effect that it would operate: (a) to absolve a contracting party from liability for failing to open a letter of credit ... and (b) would do so in circumstances where the Regulation would not in fact have been breached, if the letter of credit had been opened and utilised, but the contracting party in good faith reasonably believed that it would have been so breached" (at paragraph 23)

FOREIGN SANCTIONS AND ILLEGALITY

While beyond the scope of this article, it is important to note that the courts will not enforce a contract that is governed by English law but requires performance of an obligation in a friendly foreign county that would violate the law of that country (see, for example, *Regazzoni v KC Sethia [1944] Limited [1958] AC 301 (HL)*.) Accordingly, sanctions which do not have direct effect in the UK may have the effect of frustrating a contract governed by English law. It has even be argued that, where alternative performance is not possible, a contract is void for illegality (in *Soeximex SAS*, discussed above). However, the usual principles relating to frustration and illegality will apply, and the court will look to see whether other, legal, modes of performance remain available (a good illustration is the decision in *Libyan Arab Foreign Bank*, which concerns a US sanction).

CONCLUSION

Consideration of decisions in the last 100 years reveals a reluctance by the English courts to allow parties to escape their contractual obligations by reason of the imposition of economic sanctions. However, these cases have yet to consider the situation where the continuing performance of the contract would constitute a criminal offence.

What is clear is that, with Western governments' increasing tendency to implement sanctions in place of committing troops, the jurisprudence in this area will continue to develop.

In the meantime, it is prudent to include in contracts with non-EU parties, or involving performance outside the EU, express provisions addressing the position if economic sanctions come to be introduced in the future..