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MANAGING SANCTIONS RISK IN CONTRACTS

THE HIGH COURT PROVIDES GUIDANCE

Given the broad scope of international trade sanctions, the potential for new measures to be introduced with no warning, and the significant fines that have been imposed for sanctions breaches, we strongly recommend that all contracts for international trade should contain a robust sanctions clause. Two recent decisions of the High Court provided useful guidance on the interpretation of such clauses.

> **"Both cases reach the same view as to the effect of a sanctions clause – the clause is generally suspensory in nature, and does not permanently extinguish payment obligations."**

Most recently, in *Lamesa Investments Limited v Cynergy Bank Limited*[1] the Court showed a willingness to apply a surprisingly broad interpretation as to when a sanctions clause will apply. This contrasts with the more restrictive approach taken last year in *Mamancochet Mining Limited v Aegis Managing Agency Limited and others*[2].

Both cases highlight the importance of careful drafting, as well as an understanding of how sanctions risks arise.

Background

Under a framework agreement dated 19 December 2017, Lamesa Investments Limited ('LIL') lent Cynergy Bank Limited ('CBL') £30m. CBL was to make six-monthly payments of principal and interest to LIL.

CBL is a Cypriot based retail bank, with no connection to the US other than maintaining US correspondent banking relations.

In April 2018, LIL's ultimate owner, Mr Viktor Vekselberg, was added to the Specially Designated Nationals ('SDN') list pursuant to Executive Order 13662 under the US's Russia/ Ukraine sanctions programme, and the effect was that LIL was subject to the same measures.

Under primary sanctions it was prohibited for a US person to make payments to LIL. In addition, as a result of US secondary sanctions, non-US persons who engaged in significant transactions with LIL would also potentially be subject to sanctions themselves. This could trigger a prohibition on entering or maintaining correspondent relationships with US banks.

CBL withheld payments to LIL on the basis of the US secondary sanctions, particularly the risk of loss of its US correspondent banking relationships.

The framework agreement, which was subject to English law and jurisdiction, included the following term: "In the event that any principal or interest in respect of the…loan has not been paid … [CBL] shall not be in default if … such sums were not paid in order to comply with any mandatory provision of law, regulation or order of any court of competent jurisdiction."

Issue and judgment

The well-established common law position is that the English courts will not give effect to foreign law in order to excuse a party from performance of a contract, save where the foreign law is the law of the contract or of the place of performance[3].

The law of the contract was English law, and the place of performance was not the US. Under the general rule CBL would not be able to rely on US law (including secondary sanctions) to avoid their contractual obligations.

The question for the Court was whether the clause in the framework agreement was sufficient to oust the position at common law, and whether CBL was entitled not to make payments to LIL on the basis of potential action being taken by US regulators under US secondary sanctions.

Applying the usual rules of contractual interpretation[4], the Court held as follows:

1. The phrase 'mandatory provision of law' as used in the contract included both primary legislation and common law and was not limited to the laws of any particular jurisdiction.
2. A 'mandatory provision of law' could not be confined to laws that required compliance, but also included laws that may impose a

1 [2019] EWHC 1877 (Comm)

2 [2018] EWHC 2643 (Comm)

3 *Ralli Brothers v Campania Naviera Sota Y Aznar* [1920] 2 KB 287

4 See *Arnold v Britton* [2015] UKSC 36

penalty or sanction where a party pursues a certain course of action.

3. While US secondary sanctions do not require compliance by non-US persons, they may result in a penalty or sanction being applied to a non-US person.
4. Being unable to open or maintain correspondent relationships with US banks was a potentially ruinous risk for CBL, and would have been a result that the drafters of the framework agreement would have sought to avoid.
5. The clause was sufficient to oust the common law position (as outlined above), and provided a defence to CBL against enforcement action taken by LIL in respect of non-payment.
6. The clause suspended (but did not extinguish) CBL's repayment obligations so long as Mr Viktor Vekselberg remained on the SDN list.

This judgment gives a wide interpretation to the clause, by extending the term 'mandatory provision of law' to US secondary sanctions, even in circumstances where the clause itself did not expressly refer to sanctions.

By contrast, in *Mamancochet Mining Limited v Aegis Managing Agency Limited and others*[5], Teare J held that the mere possibility of the imposition of US secondary sanctions was insufficient to engage the Joint Hull Committee sanctions clause (as adopted by the Joint Cargo Committee).

The cases differ partly because of the relevant US position (the *Mamancochet* case hinged on interpretation of a general waiver under the Iran regulations) and partly because of differing contractual wording.

In *Mamancochet* the sanctions clause only operated if the insurer would be 'exposed to' a sanction, and Teare J held that this required an actual prohibition on effecting payment, not just a '[mere] risk that payment would incur a sanction'[6].

Both cases reach the same view as to the effect of a sanctions clause – the clause is generally suspensory in nature, and does not permanently extinguish payment obligations.

Implications

Given their significance, further litigation on sanctions clauses appears likely.

It is important to take adequate care when drafting sanctions, payment and enforcement clauses (or when adapting standard clauses) to ensure that risk is properly allocated.

Equally, it would be prudent to consider reviewing existing contracts in order to determine how they are likely to be interpreted in the event that one party seeks to rely on them to avoid their obligations, and this is challenged by the other party.

Given the suspensory nature of sanctions clauses, parties should consider whether they have procedures in place to set aside funds where payments cannot be made due to sanctions. Owing to the unpredictable nature of sanctions regimes, payment obligations may be reinstated at short notice.

For further information, please contact the author of this briefing:

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5 [2018] EWHC 2643 (Comm)
6 *Ibid.* at [49]

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