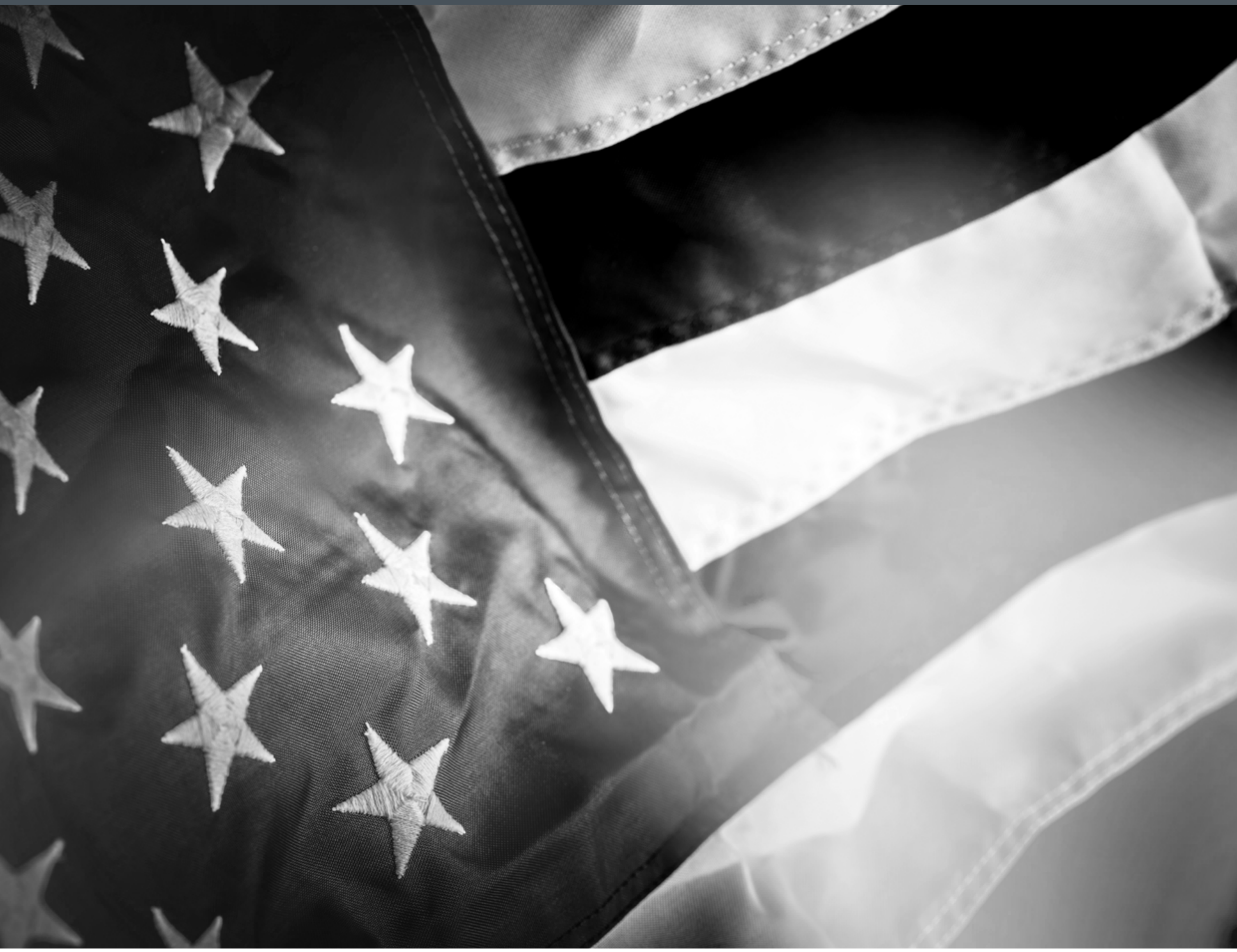


ENGLISH COURT OF APPEAL DECISION: US SECONDARY SANCTIONS ARE A "MANDATORY PROVISION OF LAW"

In *Lamesa Investments Limited v Cynergy Bank Limited*[1], the English Court of Appeal has confirmed that US secondary sanctions fall within the common wording "mandatory provision of law" and that Cynergy was complying with them when it withheld payment under a loan facility agreement.

1 *Lamesa Investments Limited v Cynergy Bank Ltd [2020] EWCA Civ 821*

"It is now clear that a borrower can rely on such a clause to avoid being in default where it withholds payment in order to comply with US secondary sanctions."

Background

Cynergy borrowed £30m for the provision of Tier 2 Capital under a loan facility agreement (LFA) with Lamesa. Shortly afterwards, the US designated the indirect owner of Lamesa as a specially designated national (SDN).

Under US secondary sanctions, the President may prohibit non-US persons identified to have conducted significant financial transactions with an SDN from maintaining US correspondent accounts.[2] Concerned about the risk of being subject to US secondary sanctions and the implications of this for their business, Cynergy withheld interest payments. They relied on Clause 9.1 of the LFA, which provided:

> *"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."*

Lamesa applied to the court for a determination as to whether Cynergy was obliged to continue making payments.

First instance decision

As detailed in our previous briefing[3], the Court at first instance[4] held that the phrase 'mandatory provision of law' meant a provision from which the parties could not derogate. This included US secondary sanctions. The judge gave particular weight to the intention of the parties in drafting the clause, especially the potentially drastic effect sanctions would have on Cynergy's business.

The Court also confirmed the suspensory effect of such clauses, as previously held in *Mamancochet Mining Limited v Aegis Managing Agency Limited and others*.[5]

Lamesa appealed.

Court of Appeal decision

The Court of Appeal upheld the decision, but deployed different reasoning.

It identified two problems with the first instance decision:

1. Clause 9.1 is a standard clause in LFAs for the provision of Tier 2 Capital. Its interpretation should focus on the words used and the context of its general application as opposed to a singular, specific commercial context.
2. It would take clear words to abrogate the borrower's obligation to repay under a loan agreement and equal weight should be given to the commercial interests of both parties. The judge at first instance may have afforded more weight to the commercial interests of Cynergy than Lamesa.

The Court of Appeal agreed that Clause 9.1 was open to multiple interpretations. 'Mandatory provision of law' could refer to:

- binding statutes that directly require non-payment (as argued by Lamesa).
- provisions of law that the parties cannot vary or disapply (as argued by Cynergy).
- requirements or prohibitions.

It then identified three relevant contextual factors:

1. The EU Blocking Regulation[6] employs similar language to Clause 9.1 and describes US secondary sanctions as imposing a "requirement or prohibition" with which EU entities are required to "comply". Those drafting Clause 9.1 would have been aware of this.
2. Clause 9.1 is a standard clause in LFAs for the provision of Tier 2 Capital to international banks.

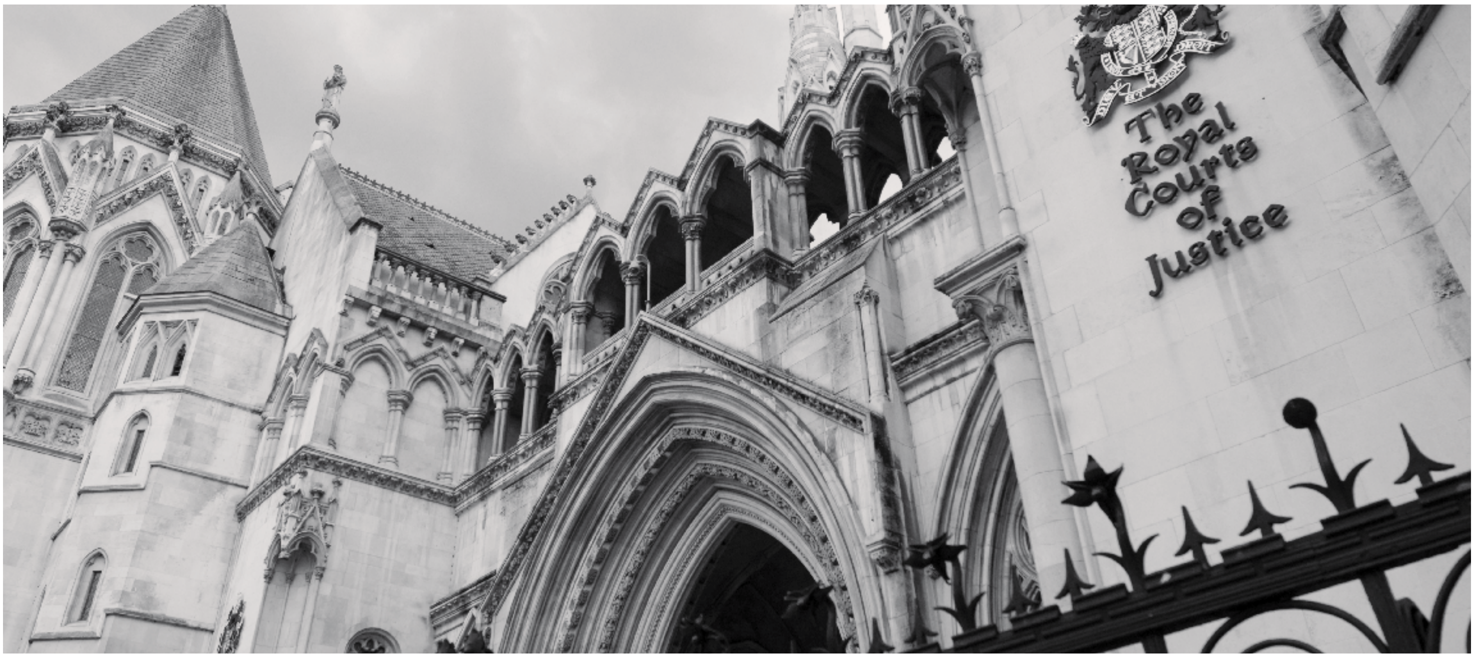
2 Section 5(b) of the Ukraine Freedom Support Act 2014 (as amended)

3 https://www.hfw.com/Managing-sanctions-risk-in-contracts-the-High-Court-provides-guidance

4 [2019] EWHC 1877 (Comm)

5 [2018] EWHC 2643 (Comm)

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



3. US secondary sanctions were at the relevant time a potential problem in agreements for the provision of Tier 2 Capital within the EU; far more so than US primary sanctions, which only apply to US persons or activities with a US nexus.

It is therefore likely that those drafting Clause 9.1 also intended a borrower to be able to obtain relief from default for non-payment in order to comply with US secondary sanctions. While the US cannot strictly speaking prohibit non-US persons from engaging in certain activities, US secondary sanctions are effectively prohibitions.

The Court of Appeal also confirmed the suspensory nature of Clause 9.1, which addressed the concern that clear words would be required to abrogate a repayment obligation under a loan agreement. The obligation to repay remained.

Implications

This judgment provides specific guidance on the wording of a clause commonly found in LFAs for the provision of Tier 2 Capital. It is now clear that a borrower can rely on such a clause to avoid being in default where it withholds payment in order to comply with US secondary sanctions.

More widely, it also confirms that US secondary sanctions effectively amount to prohibitions on the conduct of non-US persons. This is likely to have a bearing on the interpretation of sanctions clauses and exception clauses generally.

Lastly, the Court of Appeal's decision will resolve an apparent conflict with the decision in *Mamancochet Mining Limited v Aegis Managing Agency Limited and others*.[7] As discussed previously[8], in *Mamancochet*, the Court found that the risk of a sanction being imposed was not sufficient to trigger a sanctions clause, albeit in a different context. There had to be an actual prohibition rather than a "mere" risk. The Court of Appeal has now resolved that conflict by finding that a risk is sufficient.

In light of this decision, we recommend that parties make themselves aware of the allocation of risk in the sanctions clauses in their contracts, both for existing contracts and where negotiating new ones. It is also important to remember when operating a sanctions clause of this type that they are suspensory in nature; given the unpredictable nature of sanctions regimes, payment obligations may be reinstated at short notice. You should therefore have the relevant funds set aside so that payment can be made if and when sanctions are lifted.

For more information about how your business can reduce its exposure, or on any of the issues discussed above, please contact the authors of this briefing.

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7 [2018] EWHC 2643 (Comm)
8 https://www.hfw.com/Managing-sanctions-risk-in-contracts-the-High-Court-provides-guidance

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