IMPACT OF SANCTIONS ON COMMERCIAL CONTRACTS AND DOING BUSINESS

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INTRODUCTION

Two major effects that economic sanctions can have on the parties’ contractual relations are the impossibility of performing the contract and its invalidity. That is why it is important that before entering into contract with a State-owned entity or a private company, Swiss companies or investors should give particular consideration to the impact that potential sanctions may have on their contractual rights and obligations.

A former director for Iran on the National Security Council at the White House and deputy coordinator for sanctions policy at the US State Department recognised the difficulty in defining the concept of sanctions. In his view, sanctions are: “the constellation of laws, authorities, and obligations laid out in a piece of legislation, government decree, UN resolution, or similar document that restrict or prohibit what is normally permissible conduct and against which performance will be assessed and compliance will be judged [either politically or judicially].”

In legal context, the term “sanctions” is slippery, particularly in a legal context. In this regard, international law distinguishes between:

i. “retorsions”, which is the adoption by one state of an unfriendly and harmful act, which is nevertheless lawful, as a method of retaliation against the injurious legal activities of another state;

ii. “reprisals” which are acts in themselves illegal and have been adopted by one state in retaliation for the commission of an earlier illegal act by another state. They are distinguishable from acts of retorsions, which are in themselves lawful acts;

However, the term “sanctions” has a different and modern focus. It reflects the fact that these sanctions no longer refer to measures taken by a State in response to the prior unlawful conduct of another State. For example, one of the main creators of modern sanctions law is an international organisation the UN. Moreover, the UN has been joined by the EU as a major source of sanctions law. The US completes the podium.
The use of sanctions to inflict punishment is also increasingly used by other States such as China and Russia. For example, in 2019, the Chinese Ministry of Commerce made an announcement relating to the implementation of an “unreliable entities list” to which foreign entities and individuals engaged in activities that threaten national security will be added. Specific measures to be taken by China are still unknown. Countries, entities and individuals have commonly been the targets of sanctions regimes that have been imposed since the Cold War. Sanctions regimes exist in relation to the following countries or territories, either imposed by the UN Security Council, the US or the EU (or a combination of these):

i. **Africa** – Burundi, Central African Republic, Darfur, Democratic Republic of Congo, Egypt, Eritrea, Guinea-Bissau, Republic of Guinea, Libya, Mali, Somalia, South Sudan, Sudan, Tunisia and Zimbabwe.

ii. **Middle East** – Afghanistan, Iran, Iraq, Lebanon, Syria and Yemen.

The sanctions that have been imposed have taken a variety of different forms, including: arms embargoes; travel bans; freezing of assets; financial sanctions or restrictions concerning specific sectors of economic activity. Since it is the domestic law that determines the consequences of the economic sanctions, their impact on contractual relations will also be different in every specific jurisdiction. For every sanctions regime or prohibition, a court or arbitral tribunal cannot consider them in the abstract; rather, a qualification under the applicable contractual provision or the governing law is necessary.

**A. FORCE MAJEURE**

The concept of Force Majeure does not have a uniform application or recognised in the same way depending on whether it is examined from a common law or civil law perspective. For example, under English law, force majeure is not a term of art. In *Thomas Borthwick (Glasgow) Ltd v Faure Fairclough Ltd*, Donaldson J remarked that: “the precise meaning of this term, if it has one, has eluded lawyers for years.” Force majeure imports the principle that, upon the occurrence of an event or circumstance which is beyond the control of a party which prevents that party from performing some or all of its contractual obligations, that party should be relieved from a contractual liability which might otherwise arise consequent upon a failure of that party to perform those affected obligations.
Force majeure essentially recognises that an expectation of absolute contractual performance by and between contracting parties is an unrealistic proposition.

Force majeure affords relief to a party from a contractual liability which would otherwise apply in respect of a failure to perform a contractual obligation; it should not suspend the requirement for performance of the obligation itself, and in many force majeure formulations the requirement of the affected party to continue to perform its contractual obligations to the greatest possible extent is expressly stated, and rightly so.

Often, a force majeure clause will refer expressly to sanctions or embargos as a basis for claiming force majeure. However, sometimes the clause will be drafted more generically, and it will be a question of interpretation as to whether the clause is wide enough to encompass the effect of sanctions.

In addition, the party relying on the force majeure clause will need to show that it has been prevented, hindered or delayed from performing the contract by reason of the event in question. That Party must also prove that: (i) its failure to comply with its contractual obligations is beyond its control; and (ii) that it could not reasonably take any reasonable steps either to avoid or mitigate the event or the consequences of the event, for example, by obtaining a licence.

**B. THE CONCEPT OF ENGLISH COMMON LAW FRUSTRATION**

Frustration is the doctrine most commonly invoked by parties where sanctions measures are seen to interfere with the performance of pre-existing contractual obligations. A contract governed by English law may be discharged under the doctrine of frustration, which is a principle which addresses those situations where the underlying objectives of the parties in entering into a contract are defeated, without fault of either party, through changes in circumstances which are unforeseen, or on the occurrence of particular types of supervening events.

The general rule under English law is that contractual obligations are binding and absolute, so that a party is not absolved from performance merely because this has become more expensive, more difficult or even proves to be impossible. The doctrine of frustration, involves the identification of situations where it would be unjust and unreasonable to hold parties to their contracts. However, the authorities indicate that a plea of frustration ought not to be lightly invoked, since the operation of the doctrine has been kept within very narrow limits. In particular, to see if the doctrine applies “you have first to construe the contract and see whether the parties have themselves provided for the situation which has arisen. If they have provided for it, the contract must govern”.

However, successfully invoking frustration is not straightforward. Recent case law has shown that sanctions will not be held to frustrate a contract where a licence that would enable performance could be sought from the relevant authority and could be anticipated to be granted. Therefore, it seems likely that to argue successfully that a sanctions regime has frustrated a contract it would be necessary to show that no licence could have been obtained, or that despite best efforts, a licence was unobtainable.

The key points to note from the limited case law on sanctions and frustration of contracts can be summarised in three points:

i. Sanctions may reduce the scope of the obligations under a contract without frustrating the contract in its entirety;

ii. The Courts will be very unlikely to accept that the contract has been frustrated unless the party attempting to rely on frustration can show that it would be impossible to obtain a license.
iii. Even if the obligations under a contract are impossible to perform on account of sanctions, the courts may find that the contract has been suspended rather than frustrated.

C. DOCTRINES OF IMPEDIMENT AND HARDSHIP

In civil law jurisdictions there are similar concepts to the English common law doctrine of frustration. Force majeure or hardship provisions in civil codes may provide relief if contractual performance is prevented by sanctions. For example, article 273 of the UAE Civil Code provides that ‘if force majeure supervenes which makes the performance of the contract impossible, the corresponding obligation shall cease, and the contract shall be automatically cancelled’.

Article 79(1) of the United Nations Convention on Contracts for the International Sale of Goods (CISG) (adopted by both civil and common law countries) provides that a party is not liable for a failure to perform his or her obligations if he or she proves that the failure was due to an impediment beyond his or her control and that he or she could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome its consequences.

For example, German Courts have suggested that a correct application of article 79(1) must focus on assessing the risks that a party claiming to be exempt from its obligations assumed when it concluded the contract, such that if imposition of the relevant sanctions was predictable at the time of the conclusion of the contract a party would not be able to rely on the provision.

Under English law, a hardship provision in a sales contract ordinarily applies to the effect that if over time there are movements in the market relative to the contract price which result in undue and unforeseen hardship (to the buyer or the seller) then the parties will meet to discuss and seek to revise the contract price in the sales contract, which could be done by reference to the base price, the choice of indices or the percentage weightings assigned to particular indices, or could be an adjustment of the entire contract price, to something which relieves the hardship. Even in the absence of such a provision in the sales contract it would still be open for an aggrieved party to seek a dialogue with the other party in order to revise the contract price to take account of any hardship suffered.

Commentators argued that it would be prudent for parties considering inserting a clause of this nature into the sales contract to agree what hardship means exactly (such as, for example, by reference to the failure of a party to make a defined economic return) rather than simply relying on the subjective opinion of a party that something akin to hardship has arisen. Hardship is a relative concept, capable of subjective definition—as an example, it is questionable whether a party’s alleged hardship should be assessed solely in respect of the subject sales contract or by reference to a party’s wider portfolio position. A sales contract might also provide that a party cannot claim relief for hardship which that party has somehow caused for itself.

In 2003 the International Chamber of Commerce (ICC) issued a standard provision to address the alleviation of hardship, which the ICC suggests can be inserted into commercial contracts. The clause did not specifically define hardship, but the operational ambit of the clause indicates what the ICC meant by hardship since the clause was intended to apply where, in respect of an affected party:

“the continued performance of its contractual duties has become excessively onerous due to an event beyond its reasonable control which it could not reasonably have been expected to have taken into account at the time of the conclusion of the contract; and that it could not reasonably have avoided or overcome the event or its consequences”.

The ICC’s clause went on to provide that if hardship arose then the contracting parties were bound, within a reasonable time, to negotiate alternative contractual terms which reasonably allowed for the consequences of the alleged hardship event, and, failing which, the party which was claiming hardship would be entitled to terminate the contract.
D. OTHER MEANS TO AVOID LIABILITY DUE TO SANCTIONS

In addition to the concepts of force majeure and frustration, there are also the “non-liability clauses” and “no claims clauses”.

1. Non-liability clauses

Most EU Regulations imposing sanctions contain a provision, known as “non-liability clause” stating that persons acting in compliance with the relevant sanctions shall not incur any liability arising out of such compliance, provided that the persons in question act in good faith and without negligence.

The position of English Courts vis-à-vis non-liability clauses is unclear. There has been a limited number of cases where a claimant challenged an arbitral award under s.68 of the English Arbitration Act on the basis of such a clause. In the only decision that could be identified in this matter, the English Court did not address the question of whether the claimant could successfully rely on the non-liability clause in order to escape liability, but it held that the point was at least arguable.

2. No claims clauses

Most EU Regulations establishing sanctions also contain “no claims clauses”. These clauses provide that any person or entity complying with the obligations under the Regulations shall not be held liable vis-à-vis a designated person or entity for any damage that may be suffered by the latter as a result of such compliance. The interpretation of no claims clauses was raised in the case of Maud v LIA, in which the Defendant bank had served a statutory demand on the claimant seeking payment of a guarantee. The issues in the case revolved around the application of the EU’s Libya sanctions regime to the contractual relationship between the Claimant and the Defendant. In particular, the Claimant argued, among other things, that the service of the statutory demand was a “claim” and was therefore prohibited by the relevant no claims clause.

At first instance, the High Court agreed that the statutory demand was covered by the reference to a “claim under guarantee”. Moreover, the Court held that the prohibition in the clause was not limited to judgments following court proceedings. On that basis, the Court found that the clause did indeed apply to prevent the defendant serving the statutory demand.

However, the Court of Appeal overturned the first instance decision, holding that a common feature of any procedure that can properly be called a “claim” is that it may lead to the grant of the relief that the claimant seeks. In this regard, the purpose of the no claims clause was to prevent the LIA from obtaining funds owed to it by means of judicial process. The clause did not therefore cover a statutory demand, which was considered to be a precursor to the filing of a bankruptcy petition. On that basis, it could not be a “claim” for the purpose of the no claims clause.

CONCLUSION

Companies, State-owned entities and Governments have increasingly become aware and impacted by the impositions of sanctions (in its various manifestations). Sanctions have a real impact on the conduct of international business transactions and related disputes which are heard before arbitral tribunals or national courts. That is why parties engaged in business in high risk jurisdictions must carefully devise contractual mechanisms allowing them to avoid liability for their inability to perform the contract if sanctions are imposed on the jurisdiction within which they do business or if their contractual counterparty is sanctioned.

Another factor to bear in mind relates to investment in projects which require significant capital injection at the start of the project’s lifecycle (such as in the solar energy and mining sectors). It is important that before entering into a contract, Swiss companies or investors check with their banks as to whether they would in principle agree to finance a project in a high risk jurisdiction from a sanction perspective. This is crucial since there has been instances where companies struggled to secure financing for projects because financial institutions were reluctant to fund the project by fear (albeit justified or not from a legal perspective) of being in breach of US sanctions even if such sanctions have effectively been lifted.