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CONSTRUCTION ENGINEERING & INFRASTRUCTURE

Sanctions – your questions answered

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Introduction

- + Purpose of today
- + Questions which have arisen most often in practice:
- + **Part 1: Sanctions compliance**
 - Which rules apply (jurisdiction)?
 - How do we ensure compliance?
 - What are the different types of restrictions?
- + **Part 2: Contracts**
 - Can I walk away from my contract?
 - Will force majeure provisions apply/provide relief?
 - Is my contract frustrated?
 - Will the defence of Illegality apply?
 - Can I terminate or suspend my contract?
 - Could I end up in breach of my contract?
 - What provisions should I include in my contracts moving forward?

Sanctions – your questions answered

Context

- + Sanctions increasingly used to coerce rogue regimes into a change of behaviour and signal disapproval
- + Sanctions imposed against Russia, although these apply to other regimes as well
- + Different sets of sanctions rules (e.g. USA, EU and UK). Consider are there others (e.g. Switzerland, Canada, India)
- + Common denominator – authorities have the power to designate certain persons (smart sanctions)
- + “Designation criteria” for selecting targets (Reg 6, Russia (Sanctions) (EU Exit) Regulations):
 - Connection to regime
 - Involvement in wrongful behaviour
 - Sector of strategic national importance

How do I know if a party is sanctioned?

- + There are a number of key resources to check. These include e.g.:

UK

- + OFSI Consolidated Sanctions list
(<https://www.gov.uk/government/publications/financial-sanctions-consolidated-list-of-targets/consolidated-list-of-targets>)

EU

- + EU sanctioned persons list
(<https://data.europa.eu/data/datasets/consolidated-list-of-persons-groups-and-entities-subject-to-eu-financial-sanctions?locale=en>)

USA

- + OFAC consolidated persons list (<https://sanctionssearch.ofac.treas.gov/>)



How do I know if a party is sanctioned?

- + Remember that direct hits may not be the full extent of the sanctioned individuals
- + Pursuant to Regulation 7 of the Russia (Sanctions) (EU Exit) Regulations sanctions will also apply to entities under the ownership or control of a designated person. For example, this arises where:
 - Ownership usually >50% of the voting share rights
 - Right to appoint > more than half the board
- + Check analogous rules for US, EU or other applicable jurisdiction (ownership, control)
- + Keep a time-stamped record of results found
- + Keep results under review – imperative in a fast moving situation
 - Names can be added but also delisted in some circumstances



Which sanctions rules might affect me? When will the UK rules apply?

UK sanctions rules

- + Sanctions and Money Laundering Act 2018
- + Russia (Sanctions) (EU Exit) Regulations 2019
- + Administered by the Office of Financial Sanctions Implementation (“OFSI”)
- + The rules apply to undertakings active on UK territory, UK citizens or UK incorporated companies / bodies corporate

Penalties

- + Custodial sentences of up to 7 years
- + Financial penalties (S 146 of The Policing and Crime Act 2017)
 - Fine greater of £1,000,000 or 50% of transaction value
 - In 2020, Standard Chartered Bank fined £20.47 million

Which sanctions rules might affect me? When will the US rules apply?

+ **United States**

- + Administered by Office of Financial Assets Control (OFAC).
- + Rules addressed to “US persons”
 - US citizens or permanent residents
 - Subsidiaries of US parents
 - Persons physically in USA
- + Civil penalties: up to greater of \$250,000 or twice transaction value
- + Criminal penalties: fines up to \$1,000,000 and or imprisonment for up to 20 years
- + Addition to the SDN list
- + Beware payments in US\$!
- + Secondary sanctions against US persons (no link to USA)

– Exclusion from US market and banking system

Which sanctions rules might affect me? Who must comply with EU sanctions?

EU Sanctions rules

- + EU Commission in partnership with 27 EU Member States
- + All EU nationals, including entities incorporated or constituted under the law of an EU member state – regardless of where they are doing business inside or outside the EU
- + Also apply where EU or non-EU persons conduct business in the EU
- + EU says its sanctions do not have extraterritorial effect

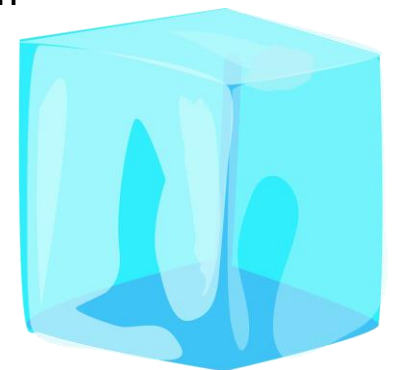
Penalties set at national level

- + EU Blocking Regulation prevents compliance with secondary sanctions award

What are the different types of sanctions?

1. Asset freezes

- + Regulation 11 of the Russia (Sanctions) (EU Exit) Regulations 2019
- + Targeted asset freezes: apply to named individuals and entities
 - No dealing with funds or economic resources belonging to or controlled by the target
 - “Used, altered or access allowed to them”
 - Prohibited to make funds or economic resources available to them – directly or indirectly (Case C-72/11 *Afrasiabi*)
 - Economic resources defined widely – all tangible and intangible goods which can be used to obtain goods or services



What are the different types of sanctions?

2. Ban on financial services (Regulation 17A)

- SoS may prohibit Russian banks from receiving sterling clearing services or correspondent banking services
- Includes wire transfers

3. Ban on provision of new debt (Regulation 17)

- A person (“P”) must not directly or indirectly grant a relevant loan if P knows, or has reasonable cause to suspect, that P is granting a relevant loan.
- Some debate about whether this covers credit under normal commercial arrangements

4. Military technology and dual use goods (Regulations 31-38)

5. Energy Technology (Regulation 39 – 46)

6. Movement of aircraft (Regulation 57J)

Can we get paid by our Russian client?

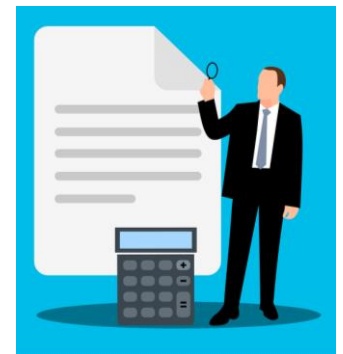
- + No general ban on trading with Russians
- + Check however whether the paying party is a designated person
- + What about their directors and shareholders? Is the client under the control of a designated person?
- + What bank will be used by the paying party? Is that bank subject to sanctions?
- + Where will the transaction be cleared?
- + As a last resort, consider seeking specific licence
- + Is the ultimate client a designated person but the immediate customer not?
 - Indirect payment of funds / payment cascade? (Regulation 19)
 - Consider whether Regulation 58 of the Russia Regulations may apply (payment through non-sanctioned party)

Can we still supply goods or services to a designated person?

- + Often first question: providers are keen to ensure that they fulfil obligations, meet deadlines and preserve valuable customer relationships
- + Under the Russia Regulations, a prohibition arises where the provision of those resources could be used to:
 - Be traded for goods or services; **or**
 - Provide a “significant financial advantage” to the target person
- + Some goods outright prohibited – e.g. military and “dual use” goods
- + Prohibition on “making economic resources available” to a sanctioned person
 - Meaning of “economic resources”?
 - “Making available” – also defined widely
 - Construction and engineering context could include e.g. provision of materials,

Can we re-structure the deal (to avoid the sanctions problem)?

- + Faced with a sanctions problem, this is a natural first question
- + Can we be confident there is no circumvention?
- + Regulation 19 of the Russia Regulations:
- + “A person must not intentionally participate in activities knowing that the object or effect of them is (whether directly or indirectly)—
 - a) to circumvent any of the prohibitions in regulations 11 to 18, or
 - b) to enable or facilitate the contravention of any such prohibition.”



Can we re-structure the deal (to avoid the sanctions problem)?

+ Case C-72/11 *Afrasiabi and Others*

- German national sought licence for export of weapons technology
- Sale to non-designated person in Iran
- However national knew that the technology would be made available to Iranian Government
- Criminal prosecution for unlawful circumvention

+ C-340/20 *Bank Sepah*: reverse burden of proof?

+ Ultimately, question must be assessed case by case. Four relevant questions:

- i. objectively assessed is there a legitimate commercial purpose for the structure proposed (other than avoiding sanctions)?
- i. is the result of the restructuring frustration of the sanctions policy?
- ii. will the project, as restructured, still benefit the designated entity?
- iii. has the project undergone a major restructuring since the sanctions came into effect?

Can I obtain a licence to carry out a prohibited activity?

Potentially, yes (and this will allow you to undertake an activity that would otherwise have been prohibited), **but:**

- + Check first for general licences – give businesses breathing space before sanctions bite
- + e.g. UK Licence INT/2022/1298776 in relation to winding down positions in Sberbank
- + Advantage – specific licence applications take time and paperwork
- + If you intend to rely on one:
 - Does it cover all aspects of your transaction?
 - Are there other jurisdictions involved? Are there equivalent permissions there?
 - Are there notification requirements?
 - Will you have enough time (given expiry of licence)?

Can I obtain a licence to carry out a prohibited activity?

Specific licence application

- + Regulation 64, Russia Regulations allows OFSI to issue specific licences
- + Application must be based on one of the pre-identified grounds set out in Schedule 5 of the Russia Regulations. Most relevant grounds are:
 - Satisfaction of an obligation of that person (whether arising under a contract, other agreement or otherwise),
 - Extraordinary situation
- + Detailed application form must be completed. Be as complete and specific as possible
 - Consider and cite in application all aspects of the transaction that could fall foul of the rules, propose a licence that would remove all risks
 - Good cover letter essential

Can I obtain a licence to carry out a prohibited activity?

- + Are other licences required? For example, if payment to be made in US\$, it is possible that an OFAC licence may also be needed
- + Shipment of materials? Consider the route of shipment
- + Managing application process
 - OFSI will engage in 4 weeks – not same as a cast iron guarantee of a licence
 - Consider where this leaves the contract and the parties' obligations (discussed further in Part II)
 - If OFSI propose a licence, consider carefully whether scope will cover all aspects of your deal
 - consider the terms of the licence. Who needs to know about these within the organisation and supply chain? Again, failure to comply is a criminal offence

Can I obtain a licence to carry out a prohibited activity?

A licence will only be good for the jurisdiction where it is issued

+ **Licensing process (United States of America)**

- Application is made directly to OFAC
- When applying for a license, provide a detailed description of the proposed transaction, including the names and addresses of any individuals/companies involved
- Penalties for false, incomplete or misleading information 19 U.S.C. § 1592 AND 1595A, 18 U.S.C. § 545, 18 U.S.C. § 1001, 50 U.S.C. APP. § 16, AND SECTION 701 ET SEQ. OF THE RELEVANT PART OF 31 C.F.R

+ **Licensing process (European Union)**

- Member States are empowered to administer the licensing process at national level
- Information sharing with other Member States
- Check carefully the grounds for licence
- For guidance on licensing in EU states, see Section V EU Best Practices Guide 2015

How do sanctions affect my insurance coverage?

Usual to include sanctions exclusion cover in policy document, e.g.:

- + **“Sanctions Clause**
- + *Insurers shall not be deemed to provide cover and Insurers shall not be liable to pay any claim or provide any benefit hereunder to the extent that the provision of such cover, payment of such claim or provision of such benefit would expose Insurers to any sanction, prohibition or restriction under United Nations resolutions or the trade or economic sanctions, laws or regulations of the European Union, United Kingdom, Canada or United States of America or any of its states.”*
- + Insurers cannot make payments to insureds who are DPs
- + *Mamancochet Mining Limited (the Claimant) v Aegis Managing Agency Limited & Others [2018]* exclusion clause upheld
- + Russian companies in aviation and space industry prevented from access to UK insurance sector

What are the key action points for sanctions compliance?

- + Have a sanctions policy – put procedures in place
 - Incorporate it into company routines
 - E.g. searches pre-negotiation, mid-negotiation, pre-closing
 - Invest in software package to conduct power searches
- + Training – ensure your staff are aware
 - Commercial
 - Accounts
- + Know your customer, but also.....
 - The end client and the purpose of the project
 - The client's shareholders
 - The currency of the contract
 - The materials to be shipped (if any) under the project and route of shipment
 - The customer's bank arrangements
 - The status of payments and shipments

Part 2: Contractual considerations

Recap: Key contractual questions covered in this topic:

- a) Can I walk away from my contract?
 - Will force majeure provisions apply/provide relief?
 - Is my contract frustrated?
 - Will the defence of illegality apply?
 - Can I terminate or suspend my contract?
- b) Could I end up in breach of my contract?
- c) What provisions should I include in my contracts moving forward?

Will force majeure provisions apply? (1)

- + Force majeure provisions may provide you with some relief.
- + Force majeure provisions typically excuse parties from performance of a contract due to events that are outside the parties' control.
- + No liability for failure to perform as a result of a force majeure event.
- + Contractual concept with no doctrine – the clause must be included in the contract for the benefit to arise.
- + Force majeure clauses are subject to the usual rules of contractual construction.
- + Key is in the wording of the clause and what the definition of force majeure covers.

Will force majeure provisions apply? (2)

Scope of the force majeure clause

- + How widely drafted is the clause? Is there a reference to “events beyond the reasonable control of the parties” or is there an exhaustive list of events?
- + War – Quite often ‘war’ is referred to in the force majeure clause or definition of a force majeure event
- + Sanctions – Less likely that sanctions is listed as a force majeure event.
 - Does the clause refer to an “Act of Government”
- + Does the drafting require the ‘prevention’ of performance by the force majeure event or require performance under the contract to be ‘hindered’?
- + Who does the clause benefit; the client, the consultant or both parties?

Will force majeure provisions apply? (3)

Relief as a result of a force majeure clause

- + Relief provided by a force majeure clause varies from contract to contract.
- + Relief from performing obligations under a contract is the most common relief provided by a force majeure clause.
- + The force majeure clause may have an impact on the payment obligations.
- + Is there an entitlement to suspend and/or terminate the contract as a result of force majeure?



Will force majeure provisions apply? (4)

The Requirement to Mitigate

- + Consider if there is a requirement to mitigate the impacts of the force majeure event.
- + Carefully consider the licensing regime available and whether this allows performance of a contract to continue.

Notification

- + Any notification requirements will need to be complied with to ensure the benefit of such clauses.

Is my contract frustrated? (1)

- + The doctrine of frustration sets a very high bar to be achieved.
- + The imposition of sanctions does not automatically frustrate a contract.
- + **Frustration**:
 - Where a serious event occurs after the formation of a contract which is both unexpected and beyond the control of the parties,...
 - which renders it impossible to fulfil the contract,...
 - ...or transforms the obligation to perform into a radically different obligation.
- + Bingham LJ - the doctrine of frustration was not to be invoked lightly and should be kept within strict limits.
- + A number of factors considered when looking at whether a contract has been frustrated.

Is my contract frustrated? (2)

- + Availability of the licensing regime will be considered.
- + **Islamic Republic of Iran Shipping Lines v. Steamship Mutual Underwriting Association (Bermuda) Limited [2010] EWHC 2661 (Comm.)**
- + Contract for the provision of indemnity insurance to cover oil tankers.
- + The Defendant argued that the contract has been frustrated by the imposition of sanctions prohibiting commercial relations with IRISL.
- + The Court did find that the sanctions in question had narrowed the scope of services, but the nature of the contract had not fundamentally changed.
- + The licence granted by the HM Treasury meant that the contract remained lawful.

Will the defence of illegality apply? (1)

- + When a contract is discharged if the performance becomes illegal.
- + A number of factors will be considered:
 - The existence of a licensing regime
 - The availability of a licence
 - The permanence of illegality - a contract can drift in and out of legality.
- + Consider the rules/sanctions applicable in the place of performance, even where the contract is an English law contract.
- + At common law: a contract will not be enforced if prohibited in the place of performance, even if lawful by the applicable law.
- + Terms of the contract should also be considered.



Will the defence of illegality apply? (2)

- + **Lamesa Investments Ltd v Cynergy Bank Ltd [2020] EWCA Civ 281**
- + The appeal concerned the interpretation of a Facility Agreement.
- + Lamesa owned by an individual who was subsequently subject to the imposition of sanctions in US.
- + Was Cynergy required to make an interest payment to Lamesa, where this was likely to result in the imposition of secondary sanctions on Cynergy?
- + Cynergy was not required to make any payment where “such sums were not paid in order to comply with any mandatory provision of law”.
- + Foreign secondary sanctions can be construed as “mandatory laws” with which parties must comply.
- + Cynergy was relieved of making the payments as it would have likely resulted in secondary sanctions being imposed on Cynergy.

Can I terminate or suspend my contract? (1)

Suspension

- + Does the contract have any of the following suspension rights?
 - Suspension for convenience
 - Suspension for non-payment
- + Consider whether suspension for non-payment under the Construction Act will apply.
- + If there are no contractual rights, consider the following commercial options:
 - Client instructed suspension
 - Suspension by agreement
- + Notice provisions must be complied with to avoid repudiatory breach!

Can I terminate or suspend my contract? (2)

Termination

- + The sanctions themselves are unlikely to be a ground for termination.
- + The terms of the contract will need to be considered carefully:
 - Termination for non-payment
 - Termination for material breach – this is a very high threshold (the breach must go to the root of the contract) and unlikely to include non-payment for example.
 - Termination for insolvency
- + Common law entitlement to terminate.
- + Commercially consider discussing termination with the client – they may be prepared to instruct termination.
- + Notice provisions must be complied with to avoid repudiatory breach!

Could I end up in breach of my contract?

- + There is a risk of repudiatory breach of the contract if:
 1. You incorrectly rely on a force majeure clause.
 2. You terminate the contract when you do not have the right to do so and/or fail to serve the correct notices.
 3. You suspend the contract when you do not have the right to do so and/or fail to serve the correct notices.
- + Balancing act – seeking to avoid being in breach of sanctions and seeking to avoid being in repudiatory breach.
- + Strategy (both commercial and legal) will be important.



What provisions should I include in my contracts moving forward? (1)

Force Majeure provisions

- + Seek to negotiate a force majeure provision into a contract to afford relief.
- + Consider drafting the clause widely and referring to both “war” and “sanctions” in the definition.
- + Rights to terminate due to a force majeure event.
- + Consider the risks of non-payment.



Termination and suspension

- + The termination and suspension provisions in a contract should be carefully considered and, if missing, termination and suspension provisions should be included.

What provisions should I include in my contracts moving forward? (2)

Sanctions drafting

- + In our view, there are benefits of including sanctions drafting in contracts moving forward.
- + Sanctions prohibitions included in professional indemnity insurance policies.
- + Liability provisions excluding liability if performance would expose you or your insurers to breach sanctions.
- + Clear entitlement to terminate.
- + Element of subjectivity should ideally be included e.g. in the reasonable opinion of the Consultant.
- + Protection of directors/corporate officers who could be fined.
- + Careful drafting will be required!

Summary

- + Put in place an effective global sanctions policy and keep it updated.
- + Be prepared to apply for licences but
 - Consider contractual position in the interim
 - Provide full and truthful application
 - Ensure compliance with terms of licence
- + Carefully consider the contract to determine whether there is adequate force majeure, termination and/or suspension drafting.
- + The requirements for frustration and illegality set the bar high, and therefore are difficult to fulfil.
- + Consider the availability of the licensing regime.
- + Seek to include protections in contracts moving forward.

Questions



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