UK Court Adopts Broad Interpretation of "No Claims" Clauses in EU Sanctions Regulations

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***Ministry of Defence & Support for Armed Forces of the Islamic Republic of Iran v. International Military Services Ltd* [2019] EWHC 1994 (Comm) (24 July 2019).** A recent decision of the English Commercial Court (the "Court") is likely to have significant repercussions for the interpretation of the so-called "*no claims*" clauses widely included in EU sanctions legislation. These provisions generally prevent persons targeted by EU sanctions from bringing claims when contracts or transactions are affected by EU sanctions restrictions. The Court adopted a broad interpretation of these provisions, which may further limit redress available in such circumstances.

Background. In 2001, an arbitral tribunal awarded the Ministry of Defence & Support for Armed Forces of the Islamic Republic of Iran ("MODSAF") damages plus interest for a breach of contract by International Military Services Ltd ("IMS"). MODSAF sought to enforce that award in the UK, but the enforcement action was stayed pending a challenge to the arbitral award in the Dutch courts. In the meantime, the EU imposed asset freezes against certain Iranian entities pursuant to Regulation 423/2007 (which later became Regulation 267/2012). In 2008, those sanctions, which remain in force, were extended to include MODSAF. As a result, IMS has been prohibited from paying any amounts under the award to MODSAF. IMS also argued, however, that it was not liable—*at all*—to pay interest on the award for the period after the sanctions were imposed. In particular, IMS argued that two provisions of the applicable sanctions legislation—Articles 38 and 42 of Regulation 267/2012—preclude liability for any interest accrued during the sanctions period.

The "No Claims" Clause Prevents MODSAF from Claiming Interest Accrued on the Arbitral Award for the Period When Sanctions Were in Force. Analogues to Articles 38 and 42 of Regulation 267/2012 exist in most EU sanctions regimes and, prior to this case, had not been subject to much scrutiny. Article 38 provides that, if the performance of a contract or transaction is affected by the sanctions measures in question, no claims shall be satisfied in relation to that contract or transaction. This is known as a "*no claims*" clause. Article 42 provides that the freezing of funds, or the refusal to make funds available to a sanctioned person, if done in good faith on the basis of the sanctions

legislation in question, shall not give rise to any liability unless the actions were taken as a result of negligence. This is known as a "*no liability*" clause.

The Court considered the relevant principles governing the interpretation of EU instruments. Mr. Justice Phillips found that the EU approach to legislative interpretation was broadly similar to that in England and Wales, but the EU approach placed greater emphasis on the purpose of the legislation. The judge found that the arbitral award itself constituted a separate transaction between the parties. As a result, the claim for interest accrued during the sanctions period was held to be a claim in respect of a transaction between a sanctioned and a non-sanctioned person. The claim was, therefore, precluded by the "*no claims*" clause.

The Court took the view that this position was supported by the purpose of the "*no claims*" clause, which was "*to prevent civil claims being brought against a party as a result of the fact that their performance of a contract or transaction was impeded by the operation of the sanctions*."

Analysis. The effect of the decision was to deprive the sanctioned party of its right to claim interest on the arbitral award for the duration of the sanctions period. The interest was not merely frozen whilst the sanctions remained in force, nor was it paid into an escrow account.

The rationale of the decision appears to be that parties should not be punished for their inability to perform contractual obligations when those obligations have been affected by the imposition of sanctions. In particular, the Court held that the purpose of the "*no claims*" clause was to "*ameliorate the impact of the sanctions regime on private relationships*." The Court held that this reasoning applied equally to the obligation to pay interest on an arbitral award, thus treating the interest as a separate, punitive component of the award itself. In so holding, the judge dismissed MODSAF's argument that, on this interpretation, its right to interest was effectively confiscated (and appropriated by IMS).

Notably, the Court did not consider that interest on an award serves to ensure that the award itself does not lose value over time, a devaluation that would confer an unfair benefit on the party liable to pay the award and a corresponding loss on the counterparty. The non-payment of interest on the award inflicts a substantial financial loss on the sanctioned entity that arguably goes beyond the scope of what was intended by the sanctions regime.

The judgment also raises questions regarding what should be done with any interest that does accrue on an award. As MODSAF argued, the decision appears to contradict the provisions of the same EU sanctions regime that allow for the payment of interest

into frozen bank accounts by financial institutions, provided that such interest is also frozen. Notably, the Court took a narrow interpretation of the "*accrued interest exception*" (Article 29), and held that, unlike Article 38, it was not concerned with the nature of a party's entitlement to interest. By this logic, could a financial institution refuse to pay interest to a frozen bank account held by a sanctioned individual by arguing that its contractual relationship with the sanctioned individual was affected by the sanctions and invoking the "*no claims*" clause?

Although this case dealt with a claim brought by a sanctioned Iranian entity, the wording of the "*no claims*" clause in question could potentially be invoked by a defendant in respect of claims brought by "*any other Iranian person*" (including non-sanctioned Iranian persons—see Article 38(1)(b)). Similarly, the "*no claims*" clause in the EU's main Russia sanctions regime—Article 11 of Regulation 833/2014—can be invoked in respect of claims brought by "*any other Russian person*" (including non-sanctioned Russian persons). As a result, the Court's decision could act as a catalyst for the invocation of "*no claims*" clauses more broadly, including in respect of claims brought by non-sanctioned persons. In respect of interest on an arbitral award, however, the party in question would have to show that its performance of the relevant transaction (*i.e.*, payment of the award) was impeded by sanctions, which would be difficult if there is no specific restriction on making funds available to the counterparty. It would be no surprise, however, to see a variation on this argument raised in the future.

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