English Court of Appeal Rules on Impact of US Secondary Sanctions

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The English Court of Appeal has upheld a decision ruling that U.S. secondary sanctions constitute a "*mandatory provision of law*" for the purpose of a contractual clause excluding liability for non-payment of interest on a loan (see Debevoise Update dated 3 October 2019). On 30 June 2020, the English Court of Appeal handed down its decision in the case of *Lamesa Investments Ltd v Cynergy Bank Ltd*. Although the Court of Appeal disagreed with much of the lower court's reasoning, it ultimately upheld the first instance decision.

Importantly, the Court of Appeal took a more commercial approach to interpreting the context and background of standard-form clauses such as the "*mandatory provisions of law*" clause. This places the case on a firmer footing than the first instance decision, which received criticism for not acknowledging the commercial realities of how and when parties use standard-form clauses. While questions remain about some of the conclusions drawn by the Court of Appeal, this decision confirms that the English courts will, in appropriate cases, accept that parties implicitly intend to account for U.S. secondary sanctions risks in their contracts.

Background. In September 2019, the English High Court held that a UK-incorporated borrower was entitled to withhold interest payments to a lender in reliance on a contractual clause allowing for non-payment where sums "*were not paid in order to comply with any mandatory provision of law, regulation or order of any court of competent jurisdiction*". The High Court held that the borrower (Cynergy) was entitled to rely on that exclusion of liability on the basis that the lender (Lamesa) was wholly owned by an entity that was, in turn, wholly owned by an OFAC-designated individual (Viktor Vekselberg). As a result, there was a risk that, if Cynergy paid the interest, it would become the target of U.S. secondary sanctions, an eventuality that could be ruinous for Cynergy's business. Applying standard English principles of contractual interpretation, the English High Court judge held that the phrase "*mandatory provision of law*" was intended to cover more than just primary or directly applicable foreign legal obligations.

Decision. The Court of Appeal found that the High Court had "*overlooked*" certain relevant factors, in particular the fact that the clause at issue was a standard term in

common usage, rather than one that was specifically negotiated for this agreement. The Court of Appeal observed that the High Court was "*rather more focused on the commercial interests of Cynergy than of Lamesa*". That finding, in turn, led the Court of Appeal to focus on what the parties likely intended.

Although the Court of Appeal accepted that the relevant clause was ambiguous, it ultimately found that the context supported Cynergy's interpretation of what constituted a "*mandatory provision of law*". Most importantly, the Court took into account the EU Blocking Regulation and found that the drafters of the contractual clause must have been aware that the Blocking Regulation treated U.S. secondary sanctions legislation as imposing a "*requirement or prohibition*".

The Court of Appeal reached the view that imposition of U.S. secondary sanctions was mandatory unless the payment in question was deemed not "significant". That was said to be equivalent to the possibility that a person investigated for a criminal offence "*will not be prosecuted or will be acquitted*". The Court of Appeal held that, although the secondary sanctions themselves did not prohibit the payment of interest, the effect was said to be "*clearly one of prohibition*", and acknowledged the "*reality*" that EU entities cannot ignore U.S. secondary sanctions.

Analysis: are U.S. secondary sanctions a "*mandatory provision of law*"? Interestingly, the question of whether U.S. secondary sanctions would necessarily follow from payment to Lamesa does not appear to have been considered in any particular detail. Like the High Court, the Court of Appeal gave only limited consideration to the fact that, since the introduction of the relevant U.S. secondary sanctions in 2017, no financial institution has been sanctioned under that provision. That would appear to weigh against the analogy advanced by Cynergy (and adopted by the Court of Appeal) regarding the investigation, prosecution and enforcement of criminal offences.

In practice, U.S. authorities historically have taken a measured approach to financial institutions engaging in transactions that could potentially result in the imposition of U.S. secondary sanctions (e.g., giving them a warning first). Due to the political discretion involved with imposing U.S. secondary sanctions, it is also considered less likely that they would be applied to major commercial entities in "friendly" jurisdictions without giving them an opportunity to change their conduct. One judge of the Court of Appeal brought up the distinction between taking an action to comply with a law and taking an action to avoid being targeted by U.S. secondary sanctions, but ultimately did not dissent from the majority judgment.

Analysis: the importance of context when drafting to mitigate sanctions risk. The Court of Appeal also reaffirmed the importance of context in interpreting contractual clauses, particularly those in common usage. The Court was persuaded that the parties

must have been aware of the EU Blocking Regulation, whose language was sufficiently similar to that of the contractual clause at issue to suggest that the parties had intended the clause to cover U.S. secondary sanctions. The decision therefore reinforces the need for parties to be cautious about using broad language when drafting exclusionary provisions. If U.S. secondary sanctions amount to a "*mandatory provision of law*", then so may other sanctions mechanisms that might otherwise be regarded as discretionary or political. In other words, parties seeking to allocate sanctions-related risks under English law-governed contracts will have to be mindful of referring not just to legally binding requirements, but also to measures which, whilst not legally binding, may be treated as "mandatory" by the English courts.

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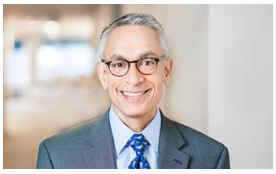

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