UK DEFENCE CLUB

Soundings

Sanctions clause bites in respect of US secondary sanctions: Lamesa v Cynergy

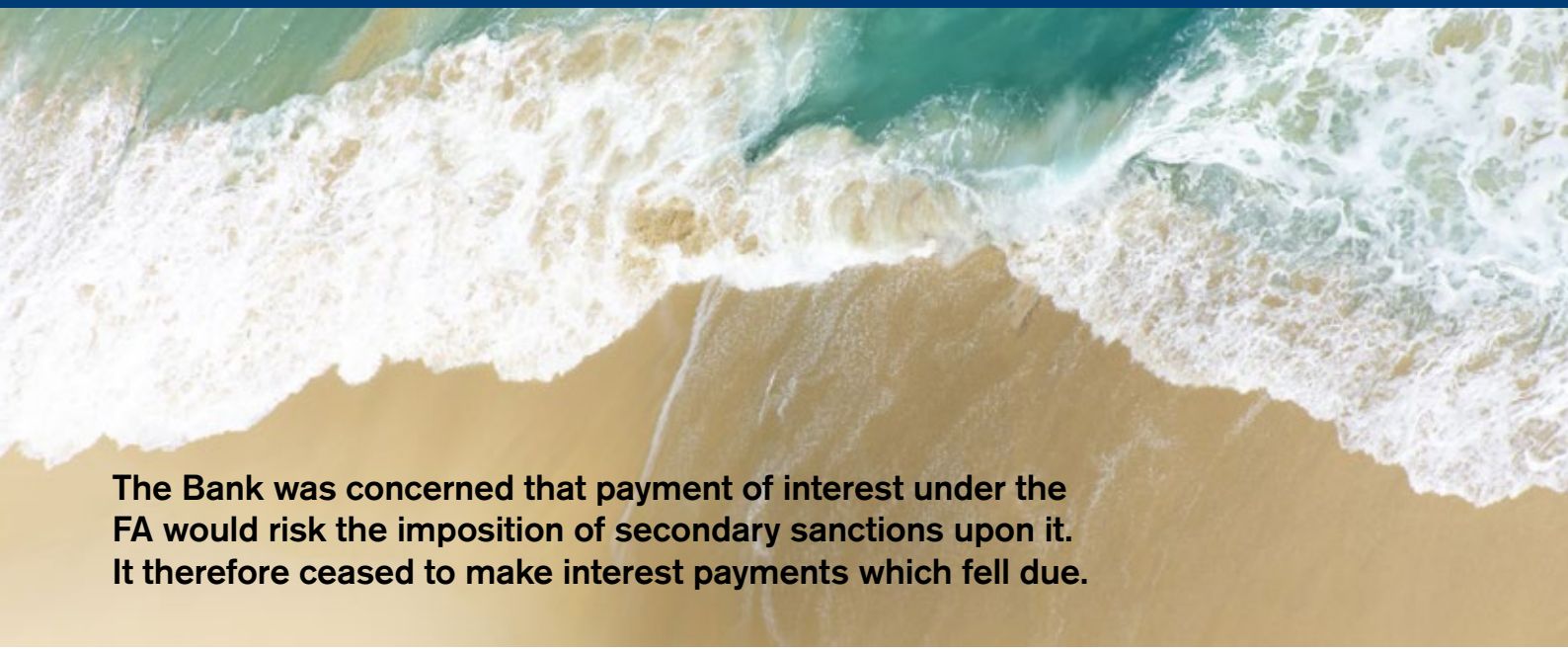
In Lamesa Investments Limited v Cynergy Bank Limited [2019] EWHC 1877 (Comm) the English Commercial Court was asked to consider whether a party could be excused from contractual performance which could expose it to US "secondary sanctions". The case is a useful reminder to consider the reach of relevant foreign sanctions and ensure contractual provisions are drafted with these in mind.

Background

Lamesa Investments Limited ("Lamesa") lent £30 million to Cynergy Bank Limited ("the Bank"), covered by a Facility Agreement ("FA"), by which the Bank was to make interest payments. The FA was subject to English law and jurisdiction. Lamesa is wholly owned by Lamesa Group Incorporated, which in turn is wholly owned by Mr Viktor Vekselberg.

Mr Vekselberg was subsequently placed on a list of "Specially Designated Nationals" ("SDN") by the US Department of the Treasury Office for Foreign Assets Control ("OFAC"). Accordingly, Lamesa became a "blocked person" by reason of its indirect ownership by Mr Vekselberg.

continued overleaf



The Bank was concerned that payment of interest under the FA would risk the imposition of secondary sanctions upon it. It therefore ceased to make interest payments which fell due.

Under US law, Section 5 of the Ukraine Freedom Support Act 2014 provides for the imposition of sanctions on a foreign financial institution (such as the Bank in this case) which has "facilitated a significant financial transaction" on behalf of a blocked person. Sanctions include "a prohibition on the opening and … maintaining in the United States of a correspondent account." The Bank is a UK registered company, trading as a retail bank in England. It maintained a US dollar correspondent account with a US bank to carry on its US dollar denominated business. The imposition of sanctions of this kind would therefore be highly detrimental to the Bank's business.

The Bank was concerned that payment of interest under the FA would risk the imposition of secondary sanctions upon it. It therefore ceased to make interest payments which fell due. The Bank sought to rely upon clause 9.1 of the FA which provided that the Bank would not be in default in respect of non-payment of interest 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."

The word "regulation" was a defined term within the FA, which included "any regulation, rule, official directive, request or guideline … of any governmental, intergovernmental or supranational body, agency, department or of any regulatory, self-regulatory, or other authority or organisation".

The decision

As a matter of English common law, contractual performance will not be excused by reference to foreign law, unless that law is the law of the contract or the law of the place of performance. The issue was therefore whether clause 9.1 of the FA modified that position.

The court held:

1. The wording "mandatory provision of law" meant a provision of law that the parties cannot vary or dis-apply;
2. It was not open to either party to dis-apply the US statutes that purported to apply secondary sanctions;
3. Contrary to Lamesa's submission, clause 9.1 was not confined to mandatory provisions of English law and was sufficient to cover US secondary sanctions – no territorial qualification was made or intended within the reference to the word "mandatory", the definition of "regulation" within the FA made that clear;
4. Clause 9.1 was drafted in wide and unqualified language in order to ensure the risk was properly and clearly managed. That was necessary in order to mitigate the common law rule referred to above; and
5. Finally, the words "in order to comply with …" were not restricted to statutes expressly prohibiting payment, but included acting so as to avoid the possible imposition of a sanction.

Accordingly, the Bank was entitled to rely on clause 9.1 of the FA to excuse its non-payment of interest payments, so long as Mr Vekselberg remained a SDN, and Lamesa remained a blocked party.

Comment

Whilst the decision turned on the facts and wording of the clause in question, parties concerned with the long-arm of US sanctions law would be well-advised to ensure contracts are drafted so as to manage the risk of breaching a prohibition which could lead to the imposition of sanctions.

Please contact the Managers for further advice in relation to any of the issues discussed above.

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