

SANCTIONS, FORCE MAJEURE AND FRUSTRATION OF CONTRACTS UNDER ENGLISH LAW

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Force Majeure

- A “force majeure” clause – will typically excuse a party from performing if an event beyond the parties’ control occurs
- Not a term of art in English law
- ***Arash Shipping Enterprises Co Ltd v Groupama Transport*** [2011] EWCA Civ 630
- The Insurers were entitled to cancel the policy “... where the Assured has exposed or may, in the opinion of the Insurer, expose the Insurer to the risk of being or becoming subject to any sanction, prohibition or adverse action in any form whatsoever against Iran by the State of the Ship(s) flag, or by the United Kingdom and/or the United States of America and/or the European Union and/or the United Nations”.

Frustration – *Taylor v Caldwell*

- Frustration - doctrine of discharge by supervening events
- *Paradine v Jane* (1647) – doctrine of absolute contracts: as a general rule, if performance of a contract becomes more difficult or even impossible the party who fails to perform is liable in damages
- *Taylor v. Caldwell* (1863) 3 B & S 826, QB

“The principle seems to us to be that, in contracts in which the performance depends on the continued existence of a given person or thing, a condition is implied that the impossibility of performance arising from the perishing of the person or thing shall excuse the performance...

We think, therefore, that the Music Hall having ceased to exist, without fault of either party, both parties are excused, the plaintiffs from taking the gardens and paying the money, the defendants from performing their promise to give the use of the Hall and Gardens and other things.”

Frustration – *Davis Contractors*

- *Davis Contractors Ltd v. Fareham Urban District Council* [1956] AC 696, House of Lords

“...Frustration occurs whenever the law recognizes that without default of either party a contractual obligation has become incapable of being performed because the circumstances in which performance is called for would render it a thing radically different from that which was undertaken by the contract... It is not hardship or inconvenience or material loss itself which calls the principle of frustration into play. There must be as well such a change in the significance of the obligation that the thing undertaken would, if performed, be a different thing from that contracted for.”

Frustration – *The Sea Angel*

- *Edwinton Commercial Corp v Tsavliris Russ (Worldwide Salvage & Towage) Ltd (the Sea Angel)* [2007] 2 All ER (Comm) 634

Among the factors which have to be considered are the terms of the contract itself, its matrix or context, the parties' knowledge, expectations, assumptions and contemplations, in particular as to risk, as at the time of contract, at any rate so far as these can be ascribed mutually and objectively, and then the nature of the supervening event, and the parties' reasonable and objectively ascertainable calculations as to the possibilities of future performance in the new circumstances...The doctrine is not to be lightly invoked; that mere incidence of expense or delay or onerousness is not sufficient and that there has to be as it were a break in identity between the contract as provided for and contemplated and its performance in the new circumstances."

Frustration

A frustrating event is an event which:

- is not due to the fault of either party (frustration cannot be ‘self-induced’);
- makes the contract “radically different” from what was contemplated by the parties;
- occurs after the contract has been formed:
 - Impossibility to perform (*Taylor v Caldwell*)
 - Frustration of purpose (the “coronation cases”)
 - Supervening illegality.
- is not provided for in the contract itself.

Frustration and Force Majeure

- *Ocean Tramp Tankers Corporation v. V/O Sovfracht, The Eugenia* [1964] 2 QB 226, Court of Appeal
“To see if the doctrine applies, you have first to construe the contract and see whether the parties have themselves provided for the situation that has arisen. If they have provided for it, the contract must govern. There is no frustration. If they have not provided for it, then you have to compare the new situation with the situation for which they did provide.”
- *Empresa Exportadora De Azucar v Industria Azucarera Nacional SA (The Playa Larga)* [1983] 2 Lloyd’s Rep. 171

Consequences of Frustration

- Automatic discharge – release from obligations to perform after the date of discharge. “Loss lies where it falls”.
- Law Reform (Frustrated Contracts) Act 1943:
 - money paid before the frustrating event can be recovered and that money due before the frustrating event, but not in fact paid, ceases to be payable;
 - a party who has incurred expenses is permitted, if the court thinks fit, to retain an amount up to the value of the expenses out of any money he has been paid by the other party before frustration; or where money was due and payable at the time of frustration, recover a sum not exceeding that amount for expenses;
 - the court may require a party who has gained a valuable benefit under the contract before the frustrating event occurred, to pay a "just" sum for it.

Frustration – Supervening Illegality

- A change in law which makes the performance illegal
- Not necessarily a ground for discharge
- But: a contract is always discharged by illegality if performance amounts to “trading with the enemy”
 - *Esposito v Bowden (1857)*
“the payment of export duties would have supplied (the enemy) directly with the means of carrying on the war”.
 - Strong public policy considerations → doctrine of frustration is not excluded by an express term of the contract.

Iran Shipping Lines

- *Islamic Republic of Iran Shipping Lines v. Steamship Mutual Underwriting Association (Bermuda) Ltd* [2010] EWHC 2661
- Multi-factorial approach in applying the doctrine of frustration; the Court divided these factors in two groups:

The first, consisting of the terms of the contract, its matrix or context, and the parties' knowledge, expectations, assumptions, and contemplations, in particular as to risk, as at the time of entry into the contract so far as these can be ascribed mutually objectively- '*ex ante factors*'.

The others (the nature of the supervening event and the parties' reasonable and objectively ascertainable calculations as to the possibility of future performance in the new circumstances) - '*post contractual*'.

Iran Shipping Lines – cont'd

- The parties had not provided for the events which occurred; and the events did not render the defendant's obligations radically different.
- Severability of the illegal obligation:
“Liability to perform a part of the contract which was still lawful could remain even though other parts of the contract have been prohibited.”

Libyan Arab Foreign Bank

- *Libyan Arab Foreign Bank v Bankers Trust Co* [1989] QB 728
- Performance of a contract is excused if (i) it has become illegal by the proper law of the contract, or (ii) it necessarily involves doing an act which is unlawful by the law of the place where the act has to be done.
- Supervening illegality does not excuse failure to perform when the obligation could but need not be performed in such a way as to cause the defendant to act illegally in the place of performance (unless a particular mode of performance is stipulated in the contract). “Delivery by the defendants of cash in London of the sums claimed would not involve illegal action in New York... Plaintiffs were entitled to receive payment in dollars or, if payment in dollars was impossible, in sterling...”

MELLI BANK V HOLBUD

- *Melli Bank plc v Holbud Limited* [2013] EWHC 1506
- Commitment fees owed to the Bank by a customer - Bank was designated under the EU sanctions regime and had its assets frozen – customer argued the contract was frustrated.
- The Court reminds the basics of the Frustration doctrine:
“a) Frustration occurs “whenever the law recognizes that without default of either party a contractual obligation has become incapable of being performed because the circumstances in which performance is called for would render it a thing radically different from that which was undertaken by the contract.” *Davis Contractors*

MELLI BANK V HOLBUD - cont'd

- b) A “multi-factorial approach” is required - *The Sea Angel*
- c) The object of the doctrine is “to give effect to the demands of justice” but it is not to be “lightly invoked” - *The Sea Angel*.

The Court ruled that the Facility Agreement was not frustrated:

- UK guidance specified that a licence allowing payment could be obtained;
- Nothing in the Facility Agreement would have left it unable to operate if circumstances were to require a licence;
- The customer did not even make enquiries re: application for a licence.

EU Regulation No 269/2014 - Derogations

- Council Regulation (EU) No 269/2014 of 17 March 2014 *concerning restrictive measures in respect of actions undermining or threatening the territorial integrity, sovereignty and independence of Ukraine*

- Article 4(1):

By way of derogation from Article 2, the competent authorities of the Member States **may authorise the release** of certain frozen funds or economic resources, or the making available of certain funds or economic resources, under such conditions as they deem appropriate, after having determined that the funds or economic resources concerned are:

EU Regulation – Article 4(1)

- (a) necessary to satisfy the **basic needs** of natural or legal persons, entities or bodies listed in Annex I, and dependent family members of such natural persons, including payments for foodstuffs, rent or mortgage, medicines and medical treatment, taxes, insurance premiums, and public utility charges;
- (b) intended exclusively for payment of reasonable professional fees or reimbursement of incurred expenses associated with the provision of **legal services**;
- (c) intended exclusively for payment of fees or service charges for routine **holding or maintenance of frozen funds** or economic resources; or
- (d) necessary for **extraordinary expenses**, provided that the relevant competent authority has notified the grounds on which it considers that a specific authorisation should be granted to the competent authorities of the other Member States and to the Commission at least two weeks prior to authorisation.

EU Regulation – Article 5(1)

By way of derogation from Article 2, the competent authorities of the Member States may authorise the release of certain frozen funds or economic resources, if the following conditions are met:

- (a) the funds or economic resources are subject to an **arbitral decision** rendered prior to the date on which the natural or legal person, entity or body referred to in Article 2 was included in Annex I, or of **a judicial or administrative decision** rendered in the Union, or a judicial decision enforceable in the Member State concerned, prior to or after that date;
- (b) the funds or economic resources will be used exclusively to satisfy claims secured by such a decision or recognised as valid in such a decision, within the limits set by applicable laws and regulations governing the rights of persons having such claims;
- (c) the decision is not for the benefit of a natural or legal person, entity or body listed in Annex I; and
- (d) recognition of the decision is not contrary to public policy in the Member State concerned.

EU Regulation – Article 6(1)

By way of derogation from Article 2 and provided that a payment by a natural or legal person, entity or body listed in Annex I is **due under a contract or agreement** that was concluded by, or under an obligation that arose for the natural or legal person, entity or body concerned, **before the date** on which that natural or legal person, entity or body was included in Annex I, the competent authorities of the Member States may authorise, under such conditions as they deem appropriate, the release of certain frozen funds or economic resources, provided that the competent authority concerned has determined that:

- (a) the funds or economic resources shall be used for a payment by a natural or legal person, entity or body listed in Annex I; and
- (b) the payment is not in breach of Article 2(2).

DVB Bank V Shere Shipping

- *DVB Bank SE (DVB) and others v. Shere Shipping Company Limited and others* [2013] EWHC 2321 (Comm)
- Borrowers defaulted under a Loan Agreement; the Borrowers, Guarantors and the Banks became subject to EU sanctions
- Borrowers submitted the Loan Agreement was discharged
- The Court disagreed:
 - The Loan Agreement was not an “economic resource”;
 - The Regulation was not drafted to allow the designated entities to suspend or avoid repayment of monies advanced prior to the date of the Regulation – their assets were frozen but not liabilities;
 - Any payments received by the Iranian Banks would be paid into frozen accounts;
 - No attempt by the Borrowers to obtain a licence.

EU Regulation – Article 7

1. Article 2(2) shall not prevent the crediting of the frozen accounts by financial or credit institutions that receive funds transferred by third parties onto the account of a listed natural or legal person, entity or body, provided that any additions to such accounts will also be frozen...

2. Article 2(2) shall not apply to the addition to frozen accounts of:

(a) interest or other earnings on those accounts;

(b) **payments due under contracts, agreements or obligations that were concluded or arose before the date** on which the natural or legal person, entity or body referred to in Article 2 has been included in Annex I; or

(c) **payments due under judicial, administrative or arbitral decisions** rendered in a Member State or enforceable in the Member State concerned;

provided that any such interest, other earnings and payments are frozen in accordance with Article 2(1).

Soeximex v Agrocorp International

- *Soeximex SAS v Agrocorp International Pte Ltd [2011] EWHC 2743 (Comm)*
- GAFTA award; pre-existing EU and US sanctions re: Burma
- Board held that Regulations applied but would provide a defence only if payment made to Burmese persons
- Appeal under Section 68(2)(2) – failure to consider all the arguments and substantial injustice
- In particular, under Article 14 of the EU Regulations, refusal in good faith to make funds available did not give rise to liability
- English court: remits the award to the arbitrators

EU Regulation – Article 10

The freezing of funds and economic resources or the refusal to make funds or economic resources available, carried out in good faith on the basis that such action is in accordance with this Regulation, shall not give rise to liability of any kind on the part of the natural or legal person or entity or body implementing it, or its directors or employees, unless it is proved that the funds and economic resources were frozen or withheld as a result of negligence.

EU Regulation – Article 11

1. No claims in connection with any contract or transaction the performance of which has been affected..., including claims for indemnity or any other claim of this type, such as a claim for compensation or a claim under a guarantee... shall be satisfied, if they are made by [designated persons/ entities.]
3. This Article is without prejudice to the right of natural or legal persons, entities or bodies referred to in paragraph 1 to judicial review of the legality of the non-performance of contractual obligations in accordance with this Regulation.

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