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GLOBAL K: ECONOMIC SANCTIONS AND TRANSNATIONAL CONTRACTS

By Kprofs2013

In late November 2013, negotiators reached agreement on a temporary accord under which Iran would halt much of its nuclear program and roll back some existing elements of it, and the United States agreed to $6 billion to $7 billion in sanctions relief, including releasing approximately $4.2 billion in oil revenue "frozen" in banks outside the United States. (The United States would continue to enforce other substantial sanctions that remain in place.) Recent coverage and commentary about the six-month U.S.-Iran deal calls to mind the fact that economic sanctions have become a pervasive feature of the transnational contract environment. (*See* Table, *infra*.)
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***Source*:** M. P. MALLOY (ed.), ECONOMIC SANCTIONS (Cheltenham, UK: Edward Elgar Publishing, forthcoming).

Two things are noteworthy about this situation. First, there is such a considerable array of sanctions in place – unilateral and multilateral, trade and financial, direct and indirect – that a state negotiating with Iran has an extensive menu from which to choose when it starts horse-trading. Second, it is probably not safe, as many casual observers still do, to view economic sanctions as unusual or "exigent," rather than a commonplace feature of contracting in the transnational market.

It could be a year or more before we know the outcome of the ongoing maneuvering between Iran and the "P5-plus-1 countries" – the permanent members of the U.N. Security Council plus Germany – but contracts practitioners and commentators should learn one thing right now. The immediate lesson to be drawn is that the potential impact of sanctions is an increasingly pervasive risk factor in transnational contracting. The risk factor arises from three distinct circumstances in contemporary transnational practice.

First, *the resurgence of U.N. mandatory sanctions practice under Chapter VII of the U.N. Charter*. Prior to 1990, U.N. sanctions practice was limited and ineffective – the classic example being the curiously stunted trade sanctions against the break-away Southern Rhodesian regime in the1960s. In response to the Iraq invasion of Kuwait in 1990, however, and largely under the leadership of the George H.W. Bush Administration, U.N. mandatory sanctions broadly and effectively isolated the occupied Kuwait and stymied

the Iraqi Government, as a prelude to the first Gulf War. The success of this program led to frequent and pervasive application of mandatory sanctions as the primary U.N. Security Council response to many crises over the decades that followed. This development means that there is now a formidable array of sanctions programs in which implementation is mandatory for all U.N. member states, actively monitored by the Security Council through sanctions committees. As a result, moving contract activities off-shore – a typical maneuver in many pre-1990 sanctions situations (including the Southern Rhodesian sanctions) – is no longer an easy and viable option. In addition, many states – and principally the United States – have continued to promulgate *unilateral* sanctions programs, often paralleling multilateral sanctions, and these have benefited from the newly pervasive incidence of sanctions as a risk factor in transnational contract practices.

Second, *the emergence of "smart sanctions" strategies in the design of sanctions programs*. Contemporary sanctions are often more carefully targeted, and include specific and distinct sanctions against intermediaries – *e.g.*, business brokers, freight forwarders, purchasing agents, banks and other financial intermediares – which means that the direct and indirect costs of sanctions avoidance and evasion have grown significantly for indirect and secondary contract actors who would not have otherwise viewed themselves as "targets" of sanctions programs.

Third, *the existence of licensing authority within sanctions programs*. Ironically, the existence of authority within participating member states to license activities and transactions otherwise affected by a sanctions program, subject to oversight by U.N. sanctions committees, has increased the ongoing compliance and enforcement impact of sanctions programs. This feature has resulted in greater accountability for transnational contract parties.

The casual observer might respond that generally applicable contract doctrines of impracticability (or impossibility) and frustration would ameliorate the impact of these developments in sanctions practice. To the contrary, I believe that the interaction of these doctrines with current practice in transnational business may be more complicated than one might expect at first glance.

It is true that, under RESTATEMENT OF THE LAW - CONTRACTS (Second) § 261, a party to a contract affected by sanctions might claim that performance has been rendered "impracticable," thus discharging its duty to perform. However, § 261 is grounded on the occurrence of an event "after a contract is made" that occurs "without his fault." The pervasiveness and persistence of an array of sanctions programs challenges both of these premises. There is no end of sanctions *already* in place, and in the typical sanctions program the party bears the burden of demonstrating that it did not know, nor had no reason to suspect, that the subject transaction was prohibited or restricted. As comment d to § 261 observes, "If

the event that prevents the obligor's performance is caused by the obligee, it will ordinarily amount to a breach by the latter. ... If the event is due to the fault of the obligor himself, this [§ 261] does not apply. As used here 'fault' may include not only 'willful' wrongs, but such other types of conduct as that amounting to breach of contract or to negligence." Of course, this dilemma exists quite aside from any administrative or criminal consequences that might be visited on the parties by a sanctions-enforcing state. Goods or services that are the subject of the contract may be susceptible to being "blocked" or "frozen" by the enforcing state.
The same problem would exist for a contracting party who attempted to invoke the doctrine of discharge by a supervening frustration under Restatement (2d) § 265. This may be a particular concern for indirect or intermediary parties, a point that is neatly demonstrated by Illustration 5 under § 265:

> A contracts to sell and B to buy a machine, to be delivered to B in the United States. B, as A knows, intends to export the machine to a particular country for resale. Before delivery to B, a government regulation prohibits export of the machine to that country. B refuses to take or pay for the machine. If B can reasonably make other disposition of the machine, even though at some loss, his principal purpose of putting the machine to commercial use is not substantially frustrated. B's duty to take and pay for the machine is not discharged, and B is liable to A for breach of contract.

Furthermore, given the typical licensing regime that is included in sanctions programs, "impracticability" may be even less apparent in a particular contracting situation. As comment d to § 261 goes on to note, " 'impracticability' means more than 'impracticality.' A mere change in the degree of difficulty or expense . . . unless well beyond the normal range, does not amount to impracticability since it is this sort of risk that a fixed-price contract is intended to cover."

One might respond, however, that if performance of a duty is made impracticable by having to comply with a domestic or foreign governmental regulation or order, then the regulation or order is "an event the non-occurrence of which was a basic assumption on which the contract was made," according to Restatement (2d) § 264. Comment a to § 264 undercuts this argument, however, because "[w]ith the trend toward greater governmental regulation, however, parties are increasingly aware of such risks, and a party may undertake a duty that is not discharged by such supervening governmental actions, as where governmental approval is required for his performance and he assumes the risk that approval will be denied. ... Such an agreement is usually interpreted as one to pay damages if performance is prevented rather than one to render a performance in violation of law." This problem is underscored by Restatement (2d) § 266, dealing with *existing* impracticability or frustration. In a situation in which, at the time a contract is made,

the party's performance is impracticable without his fault “no duty to render that performance arises,” but only if this fact is one which it had “no reason to know,” a difficult position to maintain in an environment of persistent and pervasive sanctions programs.

All of this suggests a need for caution and proactive monitoring of contract activity in the transnational market. It is extremely naïve – if not outright disingenuous – to assume that one can casually rely on traditional doctrines of impracticability (or impossibility) and frustration in transnational commerce. Over-reading these doctrines can result in bitter lessons, and embarrassment, in the modern environment of transnational contract practice.

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