The Ukraine Crisis: Contractual Consequences under English Law for Facility Agreements and Financial Contracts

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Banking services; Contracts; Default; Facility letters; Force majeure; Frustration; Material adverse change clauses; Sanctions; Ukraine

Abstract

This article considers the impact of the Ukraine crisis on English law contracts in the banking and financial services sector. It outlines the contractual terms and English law principles that are most likely to be engaged as a result of these events, and the common scenarios faced by parties to facility agreements and contracts in the over-the-counter derivatives markets.

Introduction

The Ukraine crisis has resulted in various challenges for parties to English law contracts in the banking and financial services sector. In this article we review the relevant English law contract principles and illustrate their application with reference to certain common terms found in facility agreements and contracts used in over-the-counter derivatives markets, to highlight some of these challenges.

There has been an unprecedented, largely coordinated effort between the United States, the European Union, the United Kingdom and various other nations to impose similar (but not identical) financial, trade and individual sanctions on the Russian Federation (Russia) and various Russian individuals and businesses. While short of a total embargo on Russia, it is the most restrictive package of sanctions ever imposed on a globally integrated country with a relatively sophisticated financial order. The sanctions imposed have targeted Russian state enterprises, banks, financial institutions, major corporates and individuals, many of which are deeply embedded in the global financial system. As a result, banks and financial institutions around the world have faced challenges with their existing commercial relationships as they navigate compliance with the numerous new sanctions measures.

Challenges have also arisen from the wider business and economic consequences of the Ukraine crisis, including in the form of disrupted supply chains, raw material shortages and increasing energy and commodity prices. The consequences of sanctions for banks and financial institutions can be direct or indirect. For example, even sanctions which do not prohibit a bank or financial institution from lending to, or entering into derivatives contracts with, a client or counterparty may result in that client or counterparty being unable or unwilling to meet its payment obligations under that loan or derivative transaction because such sanctions adversely impact its business. Further, global businesses such as banks are acutely aware of possible reputational risks in relation to the Ukraine crisis and possible similar events and circumstances in other regions of the world. As such, the events underpinning the topic of "sanctions" are not just compliance or legal matters.

That being said, there can be important contractual consequences which result from the Ukraine crisis, including in facility agreements and derivatives contracts. Banks and financial institutions will no doubt be reviewing existing contracts to determine their rights and obligations thereunder. This analysis should be undertaken not only with respect to existing contracts with Russian counterparties, but also for any contracts with counterparties who might nevertheless be directly or indirectly impacted by the events in Ukraine, which may include businesses with limited or no connection to Russia. For example, a borrower that is not subject to sanctions and which has no business with Russia or Ukraine might have Russian banks (or European subsidiaries of Russian banks) which are subject to sanctions as lenders in a syndicated facility agreement that it is no longer able to borrow funds from and may be required to prepay earlier than the originally scheduled maturity date (to the extent permitted to do so by the relevant sanctions). This may have a material adverse impact on that borrower's creditworthiness. Fact-specific analysis is crucial in such situations.

Banks and financial institutions have also started to consider how best to protect themselves in future contractual dealings by amending standard clauses to reflect particular circumstances or concerns, drawing on the lessons learned to date from the crisis.

In this article we consider some of the clauses commonly found in English law governed facility agreements and the 1992 and 2002 Master Agreements published by International Swaps and Derivatives Association (ISDA), which are likely to be relevant as a

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result of the events and circumstances in Ukraine, as well as some English law concepts more generally. We will also briefly consider the longer-term impact of the Ukraine crisis for banks and financial institutions, in the realm of both contractual drafting and in the area of due diligence and compliance.

English law contracts—basic principles

Before considering specific clauses, it is worth reflecting on the freedom of contract that is fundamental to English common law. Parties generally have the freedom to agree contractual terms as they see fit. Parties to a contract will generally be held to their commercial bargains, regardless of how unfair or onerous the terms transpire to be. In that context, a party's primary focus in determining its rights and remedies under a contract is to consider the wording of the contract.

The interpretation of a particular contract will of course be fact specific and will depend on, amongst other things, the language used in the contract, the conduct of the parties and the governing law of the contract. The legal analysis will also have to be balanced with commercial considerations as parties seek to preserve commercial relationships and their individual reputations.

Relevant clauses and concepts in finance documents

Certain clauses and legal doctrines are likely to be of relevance when considering the contractual position of a party to a facility agreement or to ISDA documentation. Whilst there may be deal specific provisions not referred to in this article, and the most commonly negotiated positions referred to in this article may have been amended in a particular transaction, in general there are four categories of contractual terms to be aware of in this context: provisions relating to sanctions; events of default and termination events; material adverse change (MAC) clauses; and force majeure clauses. The general English law doctrine of frustration might also be relevant. We consider each of these below.

Sanctions clauses

Sanctions clauses have become increasingly prevalent in finance documents as a result of sanctions authorities' increasing use of financial sanctions to exert pressure on foreign regimes to change their behaviour.

Sanctions clauses can vary greatly depending on the nature of the transaction and the parties involved. There are no particular "market standard" approaches. This is partly because most banks and financial institutions have established internal sanctions compliance policies and will conduct their own risk assessments on the sanctions risks and exposure potentially posed by each counterparty they enter into transactions with, based on factors such as that counterparties' jurisdiction of incorporation, who owns the counterparty and its business more generally. The provisions relating to sanctions can be hotly negotiated on a deal-by-deal basis.

In the loans context, in light of there being no settled market standard for such clause, the Loan Market Association (LMA) does not recommend particular forms of sanctions clauses, although it does now produce sanctions-related definitions and some useful guidance on the use of sanctions provisions in facility agreements.

Sanctions-related provisions in a facility agreement will typically include representations being made by the obligors that they are not sanctioned parties, that they maintain policies and procedures to ensure sanctions compliance and that they have complied with sanctions. Obligors often undertake, on an ongoing basis, that they will comply with sanctions, not use loan proceeds for sanctioned purposes and will not use proceeds derived (directly or indirectly) from sanctioned business or entities to make payments under the finance documents.

Negotiating such provisions can often assist banks and financial institutions in their initial due diligence phase, before entering into legally binding documentation with a counterparty. However, it should be noted that, if it later transpires that such a representation was incorrect when made by an obligor, or such an undertaking is breached by an obligor, the finance parties' remedies might be affected or frustrated altogether by the relevant sanctions laws and regulations. For example, such circumstances will almost always result in an event of default under the facility agreement, which in turn usually gives the lender or facility agent the right to demand to be prepaid in full immediately (or following the expiry of a grace period, if any), i.e. to accelerate the loan(s). However, the relevant sanctions may not allow a facility agent or a lender to receive funds from, or to distribute funds received by it from, a sanctioned borrower following such an acceleration.

Looking briefly at other financial products, in December 2020, ISDA produced a *Guidance Note for Addressing Sanctions Issues in ISDA Documentation* (ISDA Sanctions Guidance Note) which considers when parties may wish to include specific provisions addressing sanctions issues in ISDA documentation, and provides model clauses that can be adapted by parties for use in their negotiated agreements.

Further, the Uniform Customs and Practice governing the operation of documentary credits (UCP 600) authored by the International Chamber of Commerce (ICC), very deliberately do not state that banks do not need to honour their obligations under a documentary credit if it would breach sanctions to do so. In consolidated guidance published on sanctions clauses in trade-related products, including letters of credit, documentary collections and guarantees, the ICC cautioned that the inclusion of sanctions clauses that allow an element of discretion in letters of credit would jeopardise the independent nature of the letter of credit and its irrevocability, such that they should not be used routinely. Given their on-demand nature and purpose, some perceive sanctions carve-outs as an existential threat to documentary credits. As such, the ICC has remarked that, instead of using sanctions clauses, parties should rather be aware of the need to carefully diligence their counterparties and service suppliers and to emphasise that it is their responsibility to ensure that they do nothing that brings into question the irrevocable nature of the credit or guarantee, the certainty of payment, or the intent to honour obligations.[1] However, perhaps recognising the impact of the 2014 regime following the annexation of Crimea and resurgence in sanctions clauses broadly as a result, a 2020 addendum to its guidance noted there "may be instances in which a bank determines it wants to include a sanctions clause" and provided a model clause, with drafting guidance. The reality is that sanctions carve-outs are widely used in documentary credits because the risk of being fined substantial amounts by sanctions authorities and regulators outweighs any concerns about documentary credits being fit for purpose, especially given that most such credits relate to transactions that are highly unlikely to involve sanctioned parties or jurisdictions.

A sanctions clause may refer to "primary" sanctions with which a party must comply by virtue of their activities and jurisdiction. A party's failure to adhere to such a regime may result in regulatory authorities investigating their sanctions compliance, and lead to fines and/or other penalties being imposed, and further may amount to a breach of contract if that party has contractual obligations to comply with the specific regime.

Regardless of what the contract says, banks and financial institutions outside the US should also be mindful of complying with US sanctions with which they may not have a direct obligation to comply, but in respect of which non-compliance could result in US "secondary" sanctions being imposed directly on them. US "secondary sanctions" may include, for example, US correspondent banking restrictions designed to effectively exclude a bank or financial institution outside the US from the US economy. The imposition of such US "secondary" sanctions can be devastating for foreign banks and financial institutions, such that the threat of such "secondary" sanctions being imposed acts as a compelling reason to also comply with "primary" US sanctions, even if there is no direct nexus to the US and any contract does not require compliance with that regime.

Sanctions clauses in the context of the Ukraine crisis

The sanctions imposed in response to the Ukraine crisis create particular challenges because Western and other allied nations have not in all cases taken a uniform approach regarding which individuals and entities are subject to sanctions. Dealings with certain individuals and entities, or entities that they own or control, may be prohibited under certain sanctions regimes, but not others. Many global organisations have adopted a conservative approach, stemming from a desire to follow all the different sanctions regimes, attempting to comply with their differing, and sometimes inconsistent, restrictions. Although such an overly cautious approach may, on its face, seem sensible, it is important to consider whether that is permitted under the specific terms of the contract. Otherwise, the party may be exposed to claims for breach of contract.[2]

Most sanctions provisions in facility agreements are to cater for scenarios where the obligors are sanctioned or dealing in funds contrary to sanctions. However, the sanctions in 2022 on Russian financial institutions have meant that it is often a finance party which is a sanctioned party, and facility agreements have traditionally not expressly contemplated this scenario at all. A sanctioned lender does not automatically become a defaulting lender (where that concept exists in a facility agreement). In fact, there are no provisions which expressly state what should occur in such a scenario, hence there was a degree of uncertainty amongst market participants in the syndicated loans market. Indeed, some agency teams were so concerned to avoid breaching sanctions that they were actually not complying with their contractual obligations for a period of time on any deals involving Russian counterparties or businesses, even those that were not subject to sanctions, meaning that such agents were in serious danger of exposing themselves to contractual claims as they were unable to rely on the "breach of law or regulation" defence referred to in the next paragraph.

It is common in syndicated facility agreements for facility agents not to be obliged to do or omit to do anything if it would, or might in the facility agent's reasonable opinion, constitute a breach of any law or regulation. This is commonly accepted as meaning, for example, that a facility agent is contractually entitled not to distribute amounts received by it to a lender if to do so would result in the facility agent being in breach of applicable sanctions. In this respect, in *Mamancochet Mining Ltd v Aegis Managing Agency Ltd*,[3] the High Court held that a similar clause would only entitle a person to refuse to make a payment that it would otherwise be entitled to make where that payment is actually prohibited under the applicable sanctions, and not where payment only exposes the person to the risk of being sanctioned or that person is taking an overly cautious approach with respect to sanctions. In contrast, in *Lamesa Investments Ltd v Cynergy Bank Ltd*,[4] both the High Court and the Court of Appeal held that the defendant could withhold payments under a facility agreement in circumstances where a beneficial owner of the claimant had become a Specially Designated National and the defendant had concerns regarding the imposition of US secondary

[1] Addendum to the ICC Guidance Paper on the use of Sanctions Clauses (2014), May 2020.
[2] Note that in some circumstances a party may be able to rely on s.44 of the Sanctions and Anti-Money Laundering Act 2018, which provides protection from civil proceedings for acts done in the "reasonable belief" that they are in compliance with regulations made under the Act.
[3] *Mamancochet Mining Ltd v Aegis Managing Agency Ltd* [2018] EWHC 2643 (Comm); [2018] 2 Lloyd's Rep. 441.
[4] *Lamesa Investments Ltd v Cynergy Bank Ltd* [2019] EWHC 1877 (Comm); [2020] EWCA Civ 821.

sanctions. A clause in the facility agreement allowed for non-payment where "… such sums were not paid in order to comply with any mandatory provision of law, regulation or order of any court of competent jurisdiction".[5] Although payment would not be in breach of sanctions per se, the courts considered that a "mandatory provision" did not only refer to a prohibition that directly bound the defendant not to pay, but that the risk of US secondary sanctions being imposed was also an "effective prohibition".

In some instances, lenders who are now sanctioned entities initially sought to rely on the illegality mandatory prepayment clauses in facility agreements, requesting to have their commitments cancelled and to be prepaid in full shortly after they were added to applicable sanctions lists. In some cases, they were hoping to be prepaid by borrowers within a "wind-down period" (being a relatively short period following the addition of a bank or financial institution to a sanctions list, during which sanctions authorities sometimes allow non-sanctioned persons who have existing transactions with that bank or financial institution to terminate and pay or receive termination payments in respect of those transactions). However, in several cases borrowers disputed that a lender being sanctioned automatically resulted in it therefore being unlawful for that lender to perform its obligations or to fund or maintain its participation in existing loans. This was particularly the case where such a lender had not applied to the relevant sanctions authority for a licence to permit the lender to remain in the facility (something few affected lenders did, given the very low likelihood that the sanctions authorities would grant such a licence). *Banco San Juan Internacional Inc v Petroleos de Venezuela SA*[6] is instructive in this respect.

How will sanctions clauses be impacted in the long term by the Ukraine crisis?

While the Ukraine crisis continues and the sanctions landscape evolves, there is likely to be closer scrutiny applied to parties' internal compliance policies and the contractual clauses used in contracts to align with those compliance-related requirements. Bodies such as the ICC, the LMA and ISDA may provide further guidance on the use of particular clauses and/or update their model clauses. Participants in the syndicated loans market are considering making clear that a sanctioned lender will be deemed to be a defaulting lender and, therefore, disenfranchised from voting and not entitled to commitment fees.

Contracting parties should carefully assess the sanctions risks that will or may arise under a transaction (e.g. due to a counterparty's industry or jurisdiction), and take appropriate steps to allocate those risks under the contract.

It would also be prudent to ensure that sanctions clauses are drafted as clearly as possible, including specific identification of applicable sanctions regimes, whether the clause extends to US "secondary" sanctions and the outcome of the clause being triggered.

Events of default

Finance documents usually specify certain events which, if they occur and whilst they are continuing, give a party a right to terminate existing transactions (under ISDA documentation) or the right to accelerate and demand immediate repayment of all amounts outstanding, the cancellation of any further commitments or drawdowns, or the right to enforce any security (under a facility agreement). These events are usually called events of default (although in some instances may be referred to as acceleration or repayment events).

Events of default typically include non-payment of an amount due, a breach of financial covenants, a misrepresentation, the insolvency of an obligor/counterparty, a change of ownership of an obligor/counterparty, audit qualification and a cessation of business. Depending on the type of derivative or loan product, illegality and unlawfulness of the underlying transaction may also be specified as events of default or otherwise dealt with separately with similar remedies.

Events of default clauses in the context of the Ukraine crisis

The business and economic consequences of the Ukraine crisis may increase the likelihood of any of the aforementioned events occurring.

An illegality or unlawfulness provision may become relevant where the Ukraine crisis has, for instance, resulted in a counterparty being made subject to sanctions.

Whether an event of default has occurred or not as a result of the events and circumstances relating to the Ukraine crisis will depend on the specific factual circumstances and the exact terms in the relevant finance documents.

In the derivatives context, both the 1992 and 2002 ISDA Master Agreement include an Illegality Termination Event which, subject to certain conditions, contemplate a termination of some or all of the transactions under the relevant agreement if it becomes illegal for one or both of the parties to perform their obligations. In some scenarios, this may allow parties to close out their transactions in an orderly manner.

However as noted in the *ISDA Sanctions Guidance Note*, parties may wish to consider the inclusion of a specific Additional Termination Event to expressly address sanctions issues and provide greater certainty in circumstances where sanctions become relevant. A specific "Sanctions Termination Event" may be useful

[5] *Lamesa Investments Ltd v Cynergy Bank Ltd* [2019] EWHC 1877 (Comm); [2020] EWCA Civ 821.
[6] *Banco San Juan Internacional Inc v Petroleos de Venezuela SA* [2020] EWHC 2937 (Comm).

for parties where sanctions do not make performance of obligations illegal but for various other reasons make the continuation of the contractual relationship undesirable.

Parties to ISDA documentation with a sanctioned counterparty should also carefully consider what such documentation says about who is entitled to calculate the close-out or termination amount, as this can differ depending on which ISDA Master Agreement and which termination event applies. It can be advantageous to be the party calculating the termination or close-out amount.

As noted above, in some cases, sanctions authorities have allowed counterparties to certain contracts a period of wind down after sanctions are introduced against a given entity. Where it would otherwise be illegal and in breach of sanctions to make payments under a contract, the wind-down period gives parties a relatively short space of time in which to close-out their transaction in an orderly manner. The availability of such a period should always be considered by parties prior to relying on any illegality or event of default clause.

In the loans context, standard LMA forms include illegality provisions which provide that if it becomes unlawful for a lender to perform its obligations or to fund, issue or maintain its participation in a utilisation, then on notice to the agent its available commitment will be cancelled, and the borrower must repay the participation of each affected lender.

An agent can also usually rely on terms which prohibit it from doing anything where it would or might breach a provision of law or regulation. It may be possible for an agent to hold funds in an account until onward payment to the lender is permitted. Generally, a borrower extinguishes its obligations under a loan agreement once it has transferred funds to the agent, so the fact that the agent is unable to pay the lender, should not result in a non-payment event of default on the part of the borrower.

In most cases, banks and financial institutions will seek to close out, settle or terminate their agreements in a consensual manner in order to achieve certainty. While any settlement is being negotiated, it is important for banks and financial institutions to continue to protect their interests by reserving their rights and remedies under the transaction documents and any non-contractual rights under any relevant laws and regulations.

To create greater certainty about the impact of sanctions or the broader impact of the crisis on the performance of obligations, parties may prefer to tailor their event of default clauses (or illegality/unlawfulness provisions) to expressly refer to sanctions or any other particular potential impact that may be relevant to their specific circumstances. This will of course be a matter of negotiation between the parties.

MAC clauses

Material adverse change (MAC) clauses (sometimes referred to as material adverse effect (MAE) clauses) are designed to catch unforeseen circumstances or events which would have been difficult to forecast at the time the finance documents were signed. MAC clauses are usually triggered by any circumstances or events that may materially affect the ability of a party to perform its obligations under the finance documents, whether in terms of payments to be made, the security granted, or otherwise. Whether a circumstance or event triggers a MAC clause will depend precisely on how "material adverse change" is defined in the relevant agreement. A MAC clause may help assuage a lender's concerns in circumstances where there could be a significant deterioration in the borrower's ability to service its debt (short of insolvency), and in circumstances where its own ability to lend may be impeded.

The use of MAC clauses can vary considerably between finance documents. They are common in facility agreements, and are often incorporated in the LMA's standard form. A borrower may be required to make a representation as to the absence of a MAC at the time of execution and to repeat that representation at the time of each drawdown. If the borrower is unable to make that representation at a given time, the agreement may specify that the lender is not obliged to lend. Any misrepresentation in this context may trigger an event of default.

MAC clauses can also be directly linked to events of default such that the circumstance or event arising will in itself lead to acceleration of the agreement—this can lead to the cancelling of future commitments, and all other amounts accrued or outstanding becoming immediately due and payable, or payable on demand.

MAC clauses in the context of the Ukraine crisis

In circumstances where the Ukraine crisis has resulted in a borrower being sanctioned and/or having its assets frozen, or where the conflict has for any other reason impeded the ability of a borrower to comply with its obligations under the finance documents, a lender may consider relying on a MAC clause as a means of effecting a draw-stop, or in more severe cases accelerating the agreement.

How a MAC is defined can vary considerably between finance documents. Generally, the definitions are drafted broadly and in vague terms, leaving much room for debate as to whether a circumstance or event has in fact caused a MAC. However, in other cases, a MAC clause may be drafted in such a way that a lender is entitled to invoke the clause if it holds a subjective belief that an event led to a MAC (though that belief will have to be honest and rational).[7]

[7] *Cukurova Finance International Ltd v Alfa Telecom Turkey Ltd* [2013] UKPC 2; [2015] 2 W.L.R. 875.

A MAC clause governed by English law will be interpreted in accordance with the general principles of contract law, with courts considering the meaning of the words in the context of the agreement as a whole. A high threshold will likely have to be reached—evidencing sufficient "materiality"—before a MAC clause can be invoked. The burden of proof will fall on the party claiming a MAC to establish that threshold has been reached.

For example, in order to allege that there has been a MAC in a borrower's financial condition since the date of a loan agreement, a lender would likely have to assess the financial information for the relevant periods, and show an adverse change over that period by reference to that information (although the enquiry may not be limited to the financial information if there is other compelling evidence). The court may find that the adverse change is material if it significantly affects the borrower's ability to repay the loan in question.[8]

In practice, obtaining the relevant up-to-date financial information before having to make a decision on whether to invoke a MAC clause may not be straightforward. Further, reliance on a MAC clause may carry with it some risk, particularly if the counterparty does not agree that a MAC has occurred. The consequences of a wrongful invocation of a MAC clause by a lender could be severe, as it may find itself exposed to a significant liability to the borrower.

When considering the risks of invoking a MAC clause, lenders should think about its potential exposure to damages if the court finds that they were wrong to do so. There is conceivably less risk for a lender in seeking to invoke a MAC clause to prevent a given drawdown compared to the more dramatic step of invoking a MAC clause to accelerate a loan agreement. In the latter case, the risks will be heightened if invocation of the MAC clause causes cross-defaults across other agreements. On the other hand, invoking a MAC clause to accelerate a loan agreement may be desirable in circumstances where repayment is otherwise unlikely, such as where it is predicted that the borrower is likely to become insolvent.[9]

Obtaining a court judgment to provide a definitive answer as to whether or not a MAC clause has in fact been correctly invoked can be a time-consuming and impractical step for lenders to take. If a case were to be litigated between parties, the court would descend into an analysis of the facts surrounding the invocation of the clause, the duration and materiality of the circumstance or event, the objective intention of the parties, the parties' knowledge of the event or circumstance at the time of contracting, and the wording of the clause in the context of the whole agreement.

Given the onerous nature of this process, parties have been reluctant to litigate MAC clauses before the English courts. Therefore, there is limited useful guidance which can be taken from the relatively few cases where a court has delivered a judgment on the interpretation of a MAC clause—they are simply too case specific to be of much use elsewhere.

Due to the subjective nature of a MAC clause, parties may prefer to rely on other contractual provisions that offer greater objectivity and certainty as to whether they can be invoked. While parties may find themselves looking at their MAC clause as result of the Ukraine crisis, they are still likely to exercise a high degree of caution before seeking to rely upon it.

How will MAC clauses be impacted in the long term by the Ukraine crisis?

If prospective counterparties foresee that their finance documents may be affected by the Ukraine crisis in the future, it may be worth tailoring any MAC clause to the specific business of the borrower and circumstances that may affect that business, while also attempting to more precisely define the threshold which may trigger the clause. The more precisely defined a MAC clause, the less scope for argument as to whether the MAC clause can be invoked.

Force majeure clauses

A force majeure clause may provide relief to a party from the consequences of a failure to comply with a contractual obligation where that failure arises from the occurrence of an event outside of its control that was not foreseen by the parties at the time of contracting.

The relief provided to a party will usually be suspension of its obligations under the contract during the period of the force majeure event, and, if the event continues for a certain period of time, the right to terminate the contract without any further liability.

English law has no separate doctrine of force majeure and will not imply the concept into a contract. It is open to the contracting parties to define exactly what events or circumstances are agreed to constitute force majeure. Consequently, whether an event amounts to force majeure is always a matter of construing the specific wording in a particular contract. It is for the party relying on a force majeure clause to prove the facts that bring the clause into play.

Force majeure clauses in the context of the Ukraine crisis

Parties may consider relying on any force majeure clause in the event that a party to finance documents becomes subject to sanctions or has its assets frozen, or for any other reason the Ukraine crisis impedes their ability to comply with their obligations.

[8] *Grupo Hotelero Urvasco v Carey Value Added SL* [2013] EWHC 1039 (Comm); [2013] Bus. L.R. D45.

[9] *Lombard North Central Plc v European Skyjets Ltd* [2022] EWHC 728 (QB)—Lombard successfully argued that it had validly invoked a MAC clause to terminate a loan agreement with Skyjets (which subsequently became insolvent) and to enforce security over Skyjets' aircraft.

The legal rules (and case law) governing when a party can rely on a force majeure clause are complex. Each scenario will need to be assessed carefully on its merits by considering the facts and interpreting the words used in the clause.

"War" is often listed in the definition of a force majeure clause. However, a party seeking to rely on a force majeure clause will need to demonstrate that "war" is the cause of the non-performance. While this does not necessarily mean that one of the contracting parties must be located in one of the countries at war, it may be easier to invoke a force majeure clause where the contract in question has a direct contractual nexus with a country involved in the conflict, whether that be the location of the parties or where the contract will be performed. This poses particular challenges for parties to finance contracts, where performance is more likely to be impeded by a "secondary impact" (e.g. a change in interest rates, currency fluctuations, a change in the commercial viability/benefit of a contract or sanctions) than the war itself. In such circumstances, unless such secondary impacts are provided for (whether specifically or by general reference) the force majeure clause may not necessarily apply. The wording of the force majeure clause is key and the analysis required is nuanced, based on the specific factual circumstances and the wording of the clause.

While force majeure clauses are not often included in loan documents, they are found in the 2002 ISDA Master Agreement.

The force majeure termination clause in the 2002 ISDA Master Agreement requires that performance by a party be "prevented", or for performance to have become "impossible or impracticable", and may only be relied upon "after giving effect to any other applicable provision, disruption fallback or remedy specified" therein, and only where the party seeking to rely on the clause "could not, after using all reasonable efforts" overcome such "prevention, impossibility or impracticability".

The force majeure clause in art.36 of the UCP 600 (which governs the operation of letters of credit) provides that:

> "a bank assumes no liability or responsibility for the consequences arising out of the interruption of its business by Acts of God, riots, civil commotions, insurrections, wars, acts of terrorism, or by any strikes or lockouts or any other causes beyond its control. A bank will not, upon resumption of its business, honour or negotiate under a credit that expired during such interruption of its business."

These clauses are untested by litigation and their successful invocation will depend on the facts. Therefore, it is not possible to comment in the abstract if a force majeure could be successfully invoked in any specific Ukraine crisis scenario and the specific circumstances of the invoking party.

The English courts construe force majeure clauses strictly—in adherence to the words in the contract. English courts have previously held that the word "prevention" in a clause means "physical or legal prevention" and not merely economic unprofitability.[10] For a force majeure clause to release a party because performance has become economically more burdensome it would require "explicit terms".[11]

Further, force majeure clauses often place an onus on a party to take all reasonable steps to avoid its operation and mitigate its impact. In the sanctions context the possibility of obtaining a licence to make any required payments may need to be considered first before seeking to rely on a force majeure clause. Parties seeking to rely on force majeure clauses should also consider whether non-contractual performance of the contract would put them in the same position as envisaged by the agreement. In a recent case, the Court of Appeal decided that a claimant seeking to rely on a force majeure clause should have accepted the defendant's offer to overcome the force majeure by paying in euros and bearing the cost of conversion to US dollars, when the defendant became unable to pay in US dollars (as required by the contract) due to sanctions.[12]

How will force majeure clauses be impacted in the long term by the Ukraine crisis?

The onus is on the parties, when drafting the contract, to set the threshold for invoking the relevant force majeure clause—for example, it could be lowered by including words such as "impracticable" or "hindered". If parties, reflecting on the Ukraine crisis, anticipate that they may face problems in performing their contractual obligations as a result of it or some similar crisis, they may wish to clearly specify in the force majeure clause those relevant events that they anticipate may disrupt future performance, by reference to the specific circumstances in which they operate, so that the risk of such events or circumstances has been appropriately allocated.

Frustration

The English common law doctrine of frustration can result in parties being automatically discharged from further performance under a contract. Establishing frustration requires something to have occurred after the formation of the contract which, without the fault of either party, renders it illegal or impossible to perform, or transforms the obligation to perform into a radically different obligation from that undertaken at the moment of entry into the contract.[13]

[10] *Tennants (Lancashire) Ltd v CS Wilson & Co Ltd* [1917] A.C. 495.
[11] *Thames Valley Power Ltd v Total Gas & Power Ltd* [2005] EWHC 2208 (Comm); (2006) 22 Const. L.J. 591.
[12] *MUR Shipping BV v RTI Ltd* [2022] EWCA Civ 1406.
[13] *Davis Contractors v Fareham Urban DC* [1956] A.C. 696; [1956] 3 W.L.R. 37.

In *The Sea Angel*[14] the court stated that the doctrine of frustration requires a "multi-factorial approach", including both *ex-ante* and post-contractual factors. The *ex-ante* factors were stated to be the terms of the contract, its matrix or context, and the parties' knowledge, expectations, assumptions and contemplations, in particular as to risk, as at that time, so far as these can be mutually ascribed in an objective way. The post-contractual factors are 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.

Financial services firms will be familiar with frustration in the context of the transition away from LIBOR at the end of 2021. When the transition was announced in 2017, the FCA and Bank of England initially took the position that firms with contracts referencing LIBOR would need to proactively redraft contracts to remove references to LIBOR, and that not doing so would have risked those contracts becoming frustrated. Subsequently, however, to avoid a legal cliff edge the UK government enacted legislation providing that references to LIBOR in legacy contracts may be interpreted as a reference to a transitional "Synthetic LIBOR" to prevent swathes of legacy contracts becoming frustrated before they reach their natural end.[15] This legislative intervention was perhaps triggered by, and is exemplary of, the potentially draconian consequences of frustration which would have otherwise seen contracts discharged without parties having an obvious right of recourse in respect of future performance—something which would have caused disruption to individual commercial relationships and the wider market.

Frustration in the context of the Ukraine crisis

Parties wishing to assert that the Ukraine crisis has frustrated a contract must therefore consider how the crisis and its repercussions have rendered the contract illegal or impossible to perform. This may arise, for example, in circumstances where a finance counterparty or any secured assets become the subject of sanctions, such that repayment of monies becomes illegal or in breach of sanctions.

Establishing frustration in this context would require an application of the multi-factorial approach described in *The Sea Angel*. However, parties seeking to rely on the doctrine of frustration should be aware that it is notoriously difficult to engage successfully and English courts have previously demonstrated a reluctance to apply it. It will not be sufficient that a contract has merely become more expensive or more difficult to perform. The required threshold of "impossibility" is much higher—such as physical destruction of the subject matter of the contract,[16] or illegality of performance.[17] While the courts have previously found contracts to be frustrated in the context of wartime restrictions,[18] it is likely that the circumstances in which the doctrine of frustration will be successfully invoked by finance parties will be narrow.

Parties would also be first expected to explore possible workarounds. In the sanctions context, the possibility of obtaining a specific licence to make any required payments may need to be considered first before seeking to rely on the doctrine. If a licence could be obtained, then it is unlikely that frustration will apply.[19]

Importantly, the presence of a force majeure clause, or any other clause which provided for the risk of the supervening event occurring, may exclude the doctrine of frustration. These clauses could objectively demonstrate that the supervening event was within the parties' knowledge, expectations, assumptions and contemplations. Careful analysis should be undertaken before relying on either.

Other impacts of the Ukraine crisis on the banking and financial services sector—beyond contracts

Another area where banks and financial institutions will need to be on the front foot is in respect of their internal sanctions compliance programmes. Banks and financial institutions continue to be a target for regulatory enforcement actions such that compliance with sanctions remains of paramount importance (regardless of what is written in a contract). It is essential, therefore, for banks and financial institutions to proactively identify and manage these risks.

Before reaching the stage of entering a contract, banks and financial institutions will typically perform detailed due diligence and KYC on their prospective counterparties to seek comfort on their compliance with sanctions regimes, and will often use tools such as commercial screening databases to check for relevant sanctions risks. Significant amounts of information can be obtained at the client on-boarding stage for both anti-money laundering and sanctions purposes. Client files should be kept under review, particularly following the Ukraine crisis as the list of sanctioned individuals and entities continues to grow.

Transactions that on first blush do not appear to violate sanctions may in fact involve or be for the benefit of sanctions targets. Banks and financial institutions should therefore be mindful to not simply focus on their immediate counterparty (such as a borrower) but should also consider other parties, such as beneficial owners,

[14] *Edwinton Commercial Corp v Tsavliris Russ (Worldwide Salvage & Towage) Ltd (The Sea Angel)* [2007] EWCA Civ 547; [2007] 2 Lloyd's Rep. 517.
[15] The Critical Benchmarks (References and Administrators' Liability) Act 2021.
[16] *Taylor v Caldwell* 122 E.R. 309; [1863] 3 B. & S. 826.
[17] The English courts have previously applied this high threshold in the context of difficulties caused by war, for example in *Greenway Bros Ltd v SF Jones & Co* (1915) 32 T.L.R. 184 a rise in prices caused by outbreak of war was held not to constitute impossibility; and in *British Movietonews v London and District Cinemas* [1952] A.C. 166; [1951] 2 T.L.R. 571 a contract for supply of newsreels to cinemas was held not to be frustrated by wartime restrictions on use of film.
[18] *Denny Mott & Dickson Ltd v James B Fraser & Co Ltd* [1944] A.C. 265; 1945 S.L.T. 2.
[19] *Islamic Republic of Iran Shipping Lines v Steamship Mutual Underwriting Association (Bermuda) Ltd* [2010] EWHC 2661 (Comm); [2011] 1 Lloyd's Rep. 195.

officers, affiliates, agents, trustees and security providers. Identifying the beneficial ownership of an entity can be challenging. These are all known values engrained in compliance policies and procedures but are ever more important in light of the repercussions of the Ukraine crisis.

The UK government's focus on understanding and tackling financial crime-related issues around beneficial ownership was further highlighted by the passing of the Economic Crime (Transparency and Enforcement) Act 2022 in the early days of the Ukraine crisis. The Act establishes a new register of overseas entities which will be maintained by Companies House and will include details of beneficial owners of property in the UK. The legislation has also strengthened the unexplained wealth order (UWO) regime and the UK sanctions regime.

Closing thoughts

As we have highlighted, the Ukraine crisis has created multiple challenges for those that are party to English law contracts in the banking and financial services sector. Those challenges have arisen from the breadth of sanctions imposed by regulators at speed, the different approaches taken by different jurisdictions and the evolving geopolitical landscape. It is highly likely that potential sanctions breaches will be an area of focus for investigations and future enforcement by regulators.

It is also likely that sanctions, and the wider repercussions of the Ukraine crisis, will create fertile ground for new civil disputes. Parties should be mindful of this when entering into new contracts, and carefully consider whether amendments to standard contractual clauses (e.g. sanctions, event of default, MAC/MAE or force majeure clauses) to cater for specific risks might provide them with more appropriate coverage and thus minimise the likelihood that disputes on the application of such clauses will arise.