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The conflict in Ukraine has resulted in the disruption of innumerable commercial agreements between and among financial, manufacturing, and other entities. As recent Morgan Lewis LawFlashes have made clear, the sanctions imposed by nations and international bodies on various Russian and Belarusian persons and entities as a result of the conflict (Ukraine-Related Sanctions) are in many ways exceptional in their coordination, breadth, and speed. Russia has imposed initial countermeasures in response to the Ukraine-Related Sanctions, which could also affect the performance of commercial agreements by parties across the globe. Many US businesses are considering whether (and if so, how) the operations in Ukraine or the Ukraine-Related Sanctions might impact their and their counterparties' obligations under agreements that require performance by or with sanctioned entities.

This is certainly not the first time that international sanctions have played a role in litigation over contract performance issues. Sanctions applied in the context of geopolitical situations in nations including the former Yugoslavia, Iran, Venezuela, and Libya have led parties to invoke force majeure provisions and common law doctrines like impossibility, illegality, and frustration of purpose to excuse nonperformance. Firms can anticipate that Ukraine-Related Sanctions will be no different. As a result, US companies should evaluate their current contractual relationships and identify any agreements and/or counterparties that are impacted by Ukraine-Related Sanctions now or could be affected in the future. They should also anticipate that counterparties may invoke Ukraine-Related Sanctions in an attempt to excuse their performance under commercial agreements, and consider if and how these sanctions may impede their own ability to perform.

Despite the exceptional nature of international sanctions, their ability to excuse contractual performance generally follows traditional common law principles. This White Paper is limited to US law, which can vary based on the relevant state law at issue, and firms should engage in a multijurisdictional analysis to determine their duties and options (and those of their counterparties) under the laws of other relevant foreign nations and US states.

FORCE MAJEURE PROVISIONS

The first step for any firm evaluating its contractual relationships in light of Ukraine-Related Sanctions is to analyze the force majeure provision, if any, in the relevant agreement. A force majeure clause is "a contractual provision allocating the risk of loss if performance becomes impossible or impracticable, esp[ecially] as a result of an event or effect that the parties could not have anticipated or controlled."[1] Force majeure provisions are found in many commercial contracts. Because they can vary widely across a number of dimensions (e.g., covered events and the specificity thereof, extent of performance excused, timing issues, notice requirements), firms should scrutinize their terms closely to determine whether the force majeure clause in their contract applies in the current circumstances, its effect on the parties' obligations, and whether any notices are required to invoke the provision.

Alongside other well-known conditions such as natural disasters and war (now also relevant given the evolution of the conflict in Ukraine), force majeure provisions may include among triggering events "government actions" or similar language that could encompass the Ukraine-Related Sanctions. Where such terms are included, courts are more likely to enforce such terms when unanticipated sanctions prevent or impede one party from meeting its contractual obligations. For example, the US Court of

[1] *Black's Law Dictionary* (11th ed. 2019).

Appeals for the Eighth Circuit held that US government prohibitions on the "transfer of any Iranian property to that country" and its "refus[al] to issue any export licenses to [the seller] for sale of F-4 parts to Iran and . . . suspen[sion of] all existing licenses" excused performance of a contract for sale of aircraft parts that included a force majeure provision covering "acts of the United States Government in either sovereign or contractual capacity" and "freight embargoes."[2] Because force majeure provisions represent parties' agreement on risk allocation at the time of contracting, courts will, as a general rule, enforce them strictly as written and will look to the language of the conditions to determine enforceability.[3]

Parties invoking a force majeure provision may have to show that they took steps to avoid the triggering event and made their best efforts to perform and/or to mitigate their damages. In a case in the US Court of Appeals for the Fifth Circuit, an American oil producer attempted to invoke a force majeure provision to excuse its failure to supply oil to a Japanese firm after the Libyan government imposed an embargo against the producer.[4] The court concluded that the American producer could not rely on the force majeure provision because it could have taken steps to prevent the embargo by making a $117 million payment to the Libyan government, representing "back taxes, royalties, and oil costs" that the producer properly owed to Libya but was withholding in connection with a dispute over Libyan restrictions on its oil production.[5]

POTENTIAL COMMON LAW DEFENSES

Whether or not a contract includes a force majeure provision, a party may also seek to use common law doctrines like impossibility (or impracticability[6]), illegality, and frustration of purpose to excuse nonperformance. But the invocation of these defenses is not a talisman—their availability is highly dependent on facts, circumstances, and applicable state law. Courts generally apply these doctrines narrowly and apply familiar principles in evaluating their application to contract disputes arising out of sanctions.

Impossibility/Impracticability and Illegality

The impossibility of performance doctrine may be available when an event or circumstance destroys the "subject matter of the contract" or the "means of performance" to the extent that a party's performance is objectively impossible.[7] Because courts are highly circumspect in their application of this doctrine to the

[2] *McDonnell Douglas Corp. v. Islamic Republic of Iran*, 758 F.2d 341, 344, 347-48 (8th Cir. 1985), *cert. denied*, 474 U.S. 948 (1985).

[3] *Sage Realty Corp. v. Jugobanka, D.D.*, No. 95 CIV. 0323 RJW, 1998 WL 702272, at *5 (S.D.N.Y. Oct. 8, 1998) (declining to relieve Yugoslavian bank of obligation to pay rent based on sanctions when bank was not beneficiary of force majeure clause); *Kel Kim Corp. v. Cent. Markets, Inc.*, 70 N.Y.2d 900, 902-03, 519 N.E.2d 295, 296 (1987) (rejecting force majeure defense upon ground, among others, that force majeure provision in contract did not expressly include event relied upon by party invoking force majeure).

[4] *Nissho-Iwai Co. v. Occidental Crude Sales*, 729 F.2d 1530, 1543 (5th Cir. 1984).

[5] *Id.* at 1544.

[6] Impracticability is also available under UCC Article 2, which applies to the sale of goods. UCC § 2-615.

[7] *Kel Kim,* 70 N.Y.2d at 902, 519 N.E.2d at 296.

sanctions context, firms should consider whether Ukraine-Related Sanctions in fact make the performance contemplated in the contract objectively impossible.

A federal district court recently considered a Venezuelan oil company's attempt to invoke impossibility to excuse its failure to make payments on notes that predated certain US sanctions against Venezuelan entities, including the company.[8] The court ultimately rejected this argument because the specific US sanctions expressly did not prevent payments for *existing* debts.[9] The court also found that banks' *reluctance* and *delays* in processing payments from the company based on the banks' risk controls (rather than the sanctions themselves) did not make payment impossible, particularly since at least one bank eventually released some funds.[10]

Similarly, courts will generally not look beyond the parties to a contract in order to find that sanctions have made performance impossible. A Texas court declined to grant summary judgment in an action for breach of contract between two firms *not* on the US government's Libyan sanctions list where performance (delivery of goods) occurred completely in the United States, even though the seller suggested (but provided no evidence) that the goods were subject to a subsequent sale agreement between the buyer and a sanctioned Libyan firm.[11]

In another case, a firm that owed funds to a party subject to sanctions by the US Treasury Department's Office of Foreign Assets Control (OFAC) (under a foreign narcotics trafficking statute) was not excused from making required payments under a settlement agreement and court order where the payments were to be made to a surety company, not the sanctioned party.[12] The court explained that "Plaintiff is not confronted with any 'legal impossibility,' nor is it required to violate federal law in order to comply," where OFAC sent a letter to the *surety company* (not the plaintiff) explaining that it could not transfer funds to the sanctioned party.[13]

Where US sanctions expressly make the substance of a transaction or contractual relations with specific parties illegal, courts have been reluctant to enforce those contracts. For example, a California court rejected the claims of plaintiffs against their business partners who failed to perform on an agreement to manufacture computers in Iran because the agreement violated US sanctions against Iran.[14] The court noted that the agreement did not require the plaintiffs to obtain an OFAC license, nor did they obtain one notwithstanding the sanctions.[15]

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[8] *Red Tree Invs., LLC v. Petroleos de Venezuela, S.A.*, No. 19-CV-2519 (PKC), 2021 WL 6092462, at *5 (S.D.N.Y. Dec. 22, 2021).

[9] *Id.*

[10] *Id.*

[11] *Gen. Elec. Supply Co., a Div. of Gen. Elec. Co. v. Gulf Electroquip, Inc.*, 857 S.W.2d 591, 597 (Tex. App. 1993), *writ denied* (Aug. 26, 1993).

[12] *Rapid Check Cashing, Inc. v. Prodira S.A. de C.V. Casa De Cambio*, No. 13-24660-CV, 2014 WL 3703854, at *5 (S.D. Fla. July 10, 2014).

[13] *Id.*

[14] *Kashani v. Tsann Kuen China Enter. Co.*, 118 Cal. App. 4th 531, 547, 13 Cal. Rptr. 3d 174, 185 (2004).

[15] *Id.*

Similarly, the US Court of Appeals for the Second Circuit held that an Iranian national oil company could not enforce a contract for delivery of chemicals by a middleman (originally procured from the United States and eventually diverted to a third country) because its arrangement was illegal under a US embargo, which the Iranian firm knew.[16] The court found that, while individual contracts between the Iranian firm and the middleman "underlying its claims are legal, [the Iranian firm] is nonetheless prohibited from enforcing those agreements in a United States court because they are admittedly part and parcel of a larger plan to violate the United States trade embargo."[17]

Frustration of Purpose

Frustration of purpose may be grounds to discharge a party's contractual obligations where an event or condition so frustrates a purpose of the contract that is "so completely the basis of the contract that, as both parties understood, without it, the transaction would have made little sense"; or, as one New York state appellate court put it, the event made the agreed-upon transaction "virtually worthless" to the counterparty.[18]

The frustration of purpose doctrine is perhaps most easily understood in (but its applicability is not limited to) agreements concerning real estate, including in the sanctions context. For example, a federal court considered a Yugoslavian bank's frustration defense to its obligation to pay rent owed under a commercial lease after the bank was sanctioned under US actions during war in Yugoslavia.[19] The court noted that, as a preliminary matter, OFAC's actions—ordering the bank's employees to leave their New York office, sealing the premises, and stopping lease payments it was temporarily transmitting from the bank's frozen assets—did, in fact, frustrate the purposes of the bank's lease.[20] However, as explained below, the frustration doctrine was ultimately unavailable to the bank because the sanctions were reasonably foreseeable.[21]

LIMITATIONS ON COMMON LAW DEFENSES

These common law doctrines do not give parties carte blanche to avoid performance. Even where a strict application of these common law defenses appears to make them available, parties should be aware of a number of limitations that courts have applied to these defenses in the sanctions context.

Contractual Waivers of Defenses

Firms should review the relevant contracts to determine if they include language waiving specific defenses and/or all defenses generally. For example, the Second Circuit found that such a waiver precluded an impossibility defense asserted by a Venezuelan state oil company based on US sanctions

[16] *Nat'l Petrochemical Co. of Iran v. M/T Stolt Sheaf*, 930 F.2d 240, 243 (2d Cir. 1991).

[17] *Id.*

[18] *PPF Safeguard, LLC v. BCR Safeguard Holding, LLC*, 85 A.D.3d 506, 508, 924 N.Y.S.2d 391 (1st Dep't 2011) (internal citations omitted).

[19] *Sage Realty Corp.*, 1998 WL 702272, at *4.

[20] *Id.*

[21] *Id.* at *3-4.

against it.[22] The court concluded that the contract's terms making obligations "unconditional and absolute" and "not subject to any defense . . . termination whatsoever by reason of the invalidity, illegality or unenforceability" was broad enough to foreclose on an impossibility defense.[23]

Foreseeability of Sanctions

Common law defenses including impossibility/impracticability and frustration of purpose are also unavailable where sanctions or other related conditions were reasonably foreseeable to the breaching party. US sanctions against a Venezuelan oil company were found to be reasonably foreseeable to the company—precluding invocation of an impossibility defense—when they followed an initial round of sanctions and the contract at issue specifically discussed OFAC and sanctions licenses.[24]

Similarly, a Yugoslavian bank could not rely on a frustration of purpose defense to a breach of a commercial lease because US sanctions leading to the closure of its New York office were foreseeable based on extensive press coverage and testimony that bank officials were monitoring political developments in Yugoslavia.[25] The Fifth Circuit also declined to abrogate an arbitration venue selection clause on impossibility grounds because, in part, it was reasonably foreseeable to the Iranian state oil company that it would be impracticable for its American counterparty to participate in arbitration in Iran shortly after the Iranian Revolution.[26]

Party Contributed to Conditions Leading to Sanctions

Courts have rejected efforts to invoke these common law defenses made by parties that caused or contributed to the conditions leading to the imposition of sanctions, including state-owned enterprises whose parent government's conduct led to US sanctions.

In one such case, the Fifth Circuit refused to allow the Iranian state oil company to avoid a contractual arbitration venue clause because the company, as part of Iranian government, "bears responsibility for creating the chain of events making it impossible for an American entity reasonably" to participate in Iranian arbitration as required in the agreement.[27]

Party Could Have Performed

As with force majeure provisions, courts likely will not excuse a party's nonperformance of its contractual obligations where it could have taken steps that would have allowed it to perform notwithstanding sanctions.

In rejecting a Venezuelan oil company's impossibility defense predicated on banks' risk management practices that led to a reluctance to process the company's payments (which were not themselves covered by sanctions), a federal court noted that the company "has come forward with no evidence of

[22] *Dresser-Rand Co. v. Pdvsa Petroleo, S.A.*, No. 20-1990, 2021 WL 2878936, at *1-2 (2d Cir. July 9, 2021).

[23] *Id.*

[24] *Red Tree Invs., LLC*, 2021 WL 6092462, at *5.

[25] *Sage Realty Corp.*, 1998 WL 702272, at *3.

[26] *Nat'l Iranian Oil Co. v. Ashland Oil, Inc.*, 817 F.2d 326, 333 (5th Cir. 1987).

[27] *Id.*

the ways in which it endeavored to assure financial institutions that processing its payments was lawful" under applicable sanctions.[28]

Similarly, the Ninth Circuit declined to allow an American firm to avoid payment of an arbitration award to an Iranian state entity on grounds that the payment would be unlawful under applicable US sanctions because "[t]here has, however, been no showing that the judgment is unpayable; OFAC has discretion to issue a specific license [to the firm to make payment], and may do so."[29]

CONCLUSION

Companies engaged in commercial activities that may be affected by the conflict in Ukraine and the current Ukraine-Related Sanctions should carefully examine their relevant contracts to determine whether they or their counterparties have the right to invoke force majeure provisions.

They should also understand that, even in the absence of an applicable force majeure clause, the common law doctrines of impossibility, impracticability, illegality, and frustration of purpose have been asserted in cases in which parties have claimed that the existence of armed conflicts and governmental sanctions and restrictions impeded performance of their contractual obligations.

UKRAINE CONFLICT: HOW TO MAINTAIN GLOBAL BUSINESS CONTINUITY

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[28] *Red Tree Invs., LLC*, 2021 WL 6092462, at *5.

[29] *Ministry of Def. & Support for Armed Forces of Islamic Republic of Iran v. Cubic Def. Sys., Inc.*, 665 F.3d 1091, 1100 (9th Cir. 2011).

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