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Sanctions Update: Are US Secondary Sanctions mandatory law for the purposes of your facilities agreement?

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The English High Court has provided some useful guidance on the term "mandatory provisions of law" in a financing agreement between two parties. This is an area of interest as the concept applies widely to default, prepayment provisions and covenants/undertakings in this and many other types of agreements. The inclusion of secondary sanctions in this category may therefore pose some interesting questions for many European-based lenders and borrowers, particularly those who are not otherwise caught by the jurisdiction of US primary sanctions. The High Court's line of argumentation may also serve as inspiration to other European courts considering similar topics.

Background of the case

On 19 December 2017, the Cypriotic investment company ("Lender") and an English bank ("Borrower") entered into a facility agreement governed by English law, under which the lender provided a £ 30,000,000 million term loan to the Borrower with the Borrower being obliged to make interest payments throughout the term of the loan. The lender was ulti-mately owned by a Russian individual, who on 6 April 2018, and during the time of the court proceedings, was placed on the list of *specially designated nationals* ("SDN") by the US Treasury Office for Foreign Assets and Control ("OFAC").

The SDN-listing meant that the Lender became a *blocked person* due to its indirect ownership by the SDN. Effectively, this created a "*primary sanction*" under US law pursuant to which US persons and entities are prohibited from transacting with such SDN person. However, non-US persons, *i.e.* foreign persons and foreign financial institutions, may face US *secondary sanctions*. Secondary sanctions may apply if a non-US person are facilitating *significant transactions* on behalf of an SDN. If the Borrower's payment of interest was considered as a significant transaction it would entail that the Borrower became exposed to US secondary sanctions. For this reason, the Borrower stopped its payments to the Lender.

Interpretation of the facility agreement

The point at issue was the interpretation of a clause in the facility agreement stating that the Borrower was not in default if a situation of non-payment was "(..) *in order to comply with any mandatory provisions of law, regulation or order of any court of competent jurisdiction*." The Borrower claimed that US secondary sanctions constituted such *mandatory provisions of law* and further argued that it was entitled to stop its payments to the Lender, as continuous payment might be considered as a significant transaction with a blocked person. Conversely, the Lender argued that the word "*mandatory*" in clause 9.1 implied that only compulsory provisions under English law could refrain the Borrower from fulfilling its payment obligation, and that US secondary sanctions had no legal effect in England.

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On the basis of its interpretation of the facility agreement, the English High Court found that "*mandatory provisions of law*" covered both primary and secondary sanctions under US law, also referring to the Rome I Regulation's understanding of the phrase in reaching this conclusion. The English High Court emphasized that there was no territorial qualification made or intended under the facility agreement, as the parties did not limit the agreement to be governed by English law. Furthermore, the judge highlighted that the wording "*in order to comply*" with mandatory provisions of law should be interpreted to include both when a party acts to avoid the imposition of sanctions, as well as when a party acts to comply with an express prohibition. Accordingly, the Borrower was allowed to refrain from fulfilling its payment obligation as long as the Lender remained a *blocked person*.

Perspectives for Danish and European companies

While the case as such only holds precedent in the United Kingdom, it does mark an interesting acceptance by a European judge to consider US secondary sanctions as a mandatory provision of law applying to a non-US company. English contract law is generally more focused on a narrower literal interpretation than its Continental European counterparts and this also seems to be the case here, based on a reading of the judgment. However, while judges in other European jurisdictions may not necessarily accept the arguments made in the judgment, there is a likelihood that this reflects a more general acceptance that US secondary sanctions are a part of the legal framework that European companies are aware of and expected to abide by. Danish and European companies are therefore well advised to consider such contractual terms in financing agreements and other agreements in this light.