Sanctions risks in terms of entering into contract and its execution

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Considering the new round of sanctions implemented by the Western countries against Russia, it is advisable to take all necessary measures in order to mitigate the possible negative consequences for contractual relationships involving Russian legal entities with foreign participation and/or dealing with export operations on international markets. In this Article we will focus on the possible contractual methods to ensure such legal protection, as well as their advantages and disadvantages.

First of all, prior to entering into contracts the parties must be thoroughly investigated. Due diligence must be conducted to double-check whether or not the potential counterpart is included in the sanction list. General Managers of the counterpart, its participants (shareholders), beneficiaries and subsidiaries must also fall within the scope of the due diligence process to verify their possible presence in the sanction list.

During the pre-contractual phase it is recommended to obtain from the counterpart a letter (warranty) confirming that neither the counterpart nor its controlling/affiliated persons are included (or are threatened to be included) in the sanction list. Each party shall be obliged to inform the other party concerning possible inclusion in the sanction list or any threat thereof.

In the contract it is advisable to include a specific sanctions clause. In practice, in most cases such clauses are inserted in the contracts or a separate agreement between the parties is entered into, provided that there is a real risk that such party or its affiliated persons may be included in the sanction list. Sanctions clauses can be divided in two types. The first type is structured in accordance with the indemnity mechanism (compensation of losses) pursuant to article 406.1 of the Russian Civil Code. The second one is structured in accordance with the representation mechanism pursuant to article 431.2 of the Russian Civil Code. Indemnity is applicable for future periods and is not connected with the breach of the contract. The amount of such

compensation shall be agreed upon by the parties and cannot be decreased by the court (like for the penalty pursuant to article 333 of the Russian Civil Code). These sanctions clause are generally structured as follows:

- a party is obliged to notify the other party in case the former or its affiliated persons are included in the sanction list or there are real risks of their further inclusion in such list;
- the party included in the sanction list is obliged to compensate the other party for losses;
- the amount or the method of calculation of the losses shall be defined (ideally, the agreed amount should cover all the negative consequences incurred by a party and arising from the work with the other party that is under sanctions, i.e. potential fines, risks to be included in the sanction list, etc.).

The option with damages is generally not recommended for the following reasons. First, in the court practice there are no positive examples of awarding damages due to the work with sanctioned counterparts. Any penalty for sanctions provided for in the contract may be decreased by the court. Moreover, the claim for damages may be overruled with reference to the entrepreneurial risk of the parties in case of execution of the contract due to violations of public nature.

The option with representation assumes that the defaulting party (providing unreliable representations) must indemnify the other party all damages associated therewith. There is also the possibility to withdraw from the contract or to claim that the contract is invalid. However, the existing court practice illustrates difficulties in the implementation of this mechanism. For instance, in the Decision of the Supreme Court of Russia dated 15.10.2018 in the case No. 305-ЭС18-16082 the court overruled the claim for invalidation of the contract due to breach of the sanctions clause in the form of representation. The reason was the absence of any evidence confirming the intention of the defaulting party to provide unreliable information that may have an impact on the other party's decision to enter into the contract.

Rather frequently, in practice, the parties consider sanction risks as force-majeure. Sanction risks are normally described as follows: prohibitions and limitations applied by state authorities to import operations (including economic sanctions, official requirements, quota and price control), nationalization, expropriation and confiscation of any assets, inclusion of the party and its affiliated persons in the sanction lists. The court practice in this regard is rather contradictory. There are court decisions that confirm sanction risks as force-majeure and consider them as acts beyond the will of the parties to the contract (Decision of the Supreme Court of Russia dated 14.08.2018 in the case No. A40-32123/2017). However, there are also other examples in court practice where such circumstances were considered as commercial risks of the parties that, for example, do not exempt the supplier from the obligation to deliver the equipment in due time as envisaged by the contract (Decision of the Commercial court of the North Caucasus District dated 13.09.2018 in the case No. A53-3447/2018).

Summarizing the above, we would like to highlight that none of the described contractual methods may give full protection against sanctions. Therefore, it is very important during the pre-contractual phase to consider the grounds for unilateral out-of-court termination of the contract. Within the context of court proceedings, it is always possible to face with a court ruling concerning the principles of public nature and entrepreneurial risk of the parties. It is also crucial to pay proper attention to sanction compliance and due diligence regarding the choice of the counterparts.



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