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"IMPOSSIBLE" OR A BAD EXCUSE? THE USES AND ABUSES OF INTERNATIONAL SANCTIONS AS A DEFENSE TO CONTRACTUAL PERFORMANCE

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Over several decades, as part of its foreign policy and national security strategies, the United States has enacted various sanctions programs targeting different countries to induce compliance with its economic and strategic objectives. These sanctions vary from relatively narrow and targeted (for instance, sanctions against certain African nations that are largely limited to trade in weapons and defense industry services) to sweeping coercive sanctions that amount to an embargo against hostile nations (for instance, sanctions against North Korea and Iran, which effectively bar all trade, with limited exceptions for humanitarian purposes).

In 2014, the United States enacted its first major set of sanctions against the Russian Federation since the days of its Soviet Union predecessor. Invoking his authority under the International Emergency Economic Powers Act, then-President Barack Obama issued Executive Order No. 13660 and 13661, both of which restricted trade, investment, and dealings in property with individuals associated with the Russian state and its defense industry. In 2021, Executive Order No. 14024 expanded those sanctions to encompass a wider range of Russian state institutions, followed by much more dramatic expansions in 2022 to private financial institutions, technology firms, and aerospace and electronics suppliers, all ultimately culminating with sanctions that now reach virtually all Russian companies that contribute in any material way to its defense or financial industries. *See generally Kyocera Document Sols. Am., Inc. v. Div. of Admin.*, 708 F. Supp. 3d 531, 539 (D.N.J. 2023).

These sanctions disrupted existing supply chains and commercial relationships, at times legally forbidding parties accustomed to cross-border transactions from continuing with those transactions – even those governed by long-term contracts and framework agreements. What then?

Ordinarily, of course, the law places the burden of losses caused by non-performance of a contract with the non-performing party, but doctrines such as impossibility of performance, frustration of purpose, and force majeure can also excuse non-performance in circumstances genuinely outside the control of and not contemplated by the parties. Sanctions certainly can and often do frustrate performance of contracts by one or both parties and are thus a potential basis to invoke these doctrines. But sanctions can also create an opening for the less scrupulous, who might raise them as a convenient but ultimately contrived excuse not to perform under duly agreed contracts that they no longer deem favorable.

This article examines the ways in which courts in the United States and United Kingdom have applied these doctrines in the wake of different sanctions regimes, to better understand when impossibility and its related doctrines might legitimately excuse performance, and when they are simply lame excuses.

Impossibility, Force Majeure, and Frustration of Purpose

While the doctrines of impossibility, frustration of purpose, and force majeure show considerable overlap, they are not entirely interchangeable and can have varying requirements and elements in different United States and common law jurisdictions.

Typically, however, in the United States, impossibility or impracticability excuses a party from performance under three conditions: First, that performance must truly be objectively impossible, not merely unprofitable or unduly burdensome, usually requiring either the destruction of the subject matter of the contract or all means of performance. Second, and relatedly, the party seeking to excuse non-performance must show that it did almost everything within its power to perform (not merely "reasonable efforts"), including the exhaustion of available judicial remedies. Third, the event or act rendering performance impossible must have been unanticipated both subjectively and objectively: that is, neither party anticipated that event *or reasonably could have* anticipated it. *See generally Inter-Am. Dev. Bank v. Nextg Telecom Ltd.*, 503 F. Supp. 2d 687, 696 (S.D.N.Y. 2007). Unanticipated acts of state that prohibit performance, including official executive and administrative orders, may satisfy these three criteria, so long as the non-performing party did not have a hand in putting those prohibitions into place. *See* 30 Williston on Contracts § 77:62 (4th ed.).

Frustration of purpose applies under similar conditions, but with one key difference: it can apply when performance might still technically be possible, but would be entirely pointless. More precisely, the defense may apply when: First, an extremely severe event must occur – words like "cataclysmic" are often used. Second, as with impossibility, the event must have been unforeseeable. Third, the unforeseen event must so disrupt the circumstances under which the parties entered the contract that it would have made little objective sense to enter the contract at all had the parties known of it in advance. *See generally Gap Inc. v. Ponte Gadea New York LLC*, 524 F. Supp. 3d 224, 234 (S.D.N.Y. 2021).

Force majeure is a doctrine that to a large extent blends impossibility and frustration. Unlike those doctrines, however – which are common law rules that may apply when the contract is silent – force majeure focuses on contingencies specified in the contract itself. The defense can apply when three conditions are met: First, the contract must excuse performance upon the occurrence of a specified event or condition outside the parties' control. Second, unless the contract itself clearly imposes a lesser threshold, that condition must render performance impossible or frustrate the purpose of the contract – again, mere burdensomeness or economic infeasibility is not enough on its own to validly trigger a force majeure clause. Third, the specific occurrence of that condition must be unforeseeable (this seems to be in tension with the first element – for how could the parties specify an event that is not foreseeable? – but the idea here is that only fortuitous events such as military conflict, natural disasters, and severe weather events qualify for inclusion in a proper force majeure clause). *See generally Zero Carbon Holdings, LLC v. Aspiration Partners, Inc.*, 732 F. Supp. 3d 326, 361 (S.D.N.Y. 2024). Again, unforeseen government action and regulation is typically deemed to be a type of event that is properly within the scope of a force majeure clause.

It is not hard to imagine situations in which these defenses might implicate contracts between companies in a complex cross-border supply chain. The most obvious would be when sanctions are imposed on one of the parties to a contract, prohibiting any further course of dealings between them. But more subtle problems can arise as well. Banking and financial facilities become very difficult to access by entities subject to sanctions (an especially difficult problem for dollar-denominated transactions), potentially making payment impossible. Distributors accustomed to purchasing goods for resale to markets that are suddenly subject to widespread sanctions might find that the purpose of those purchase contracts has been frustrated.

But do such situations always meet the stringent requirements for legally excusing performance, or are they sometimes an opportune excuse not to perform?

The following decisions provide real-world examples of how the courts have resolved such disputes.

Case Illustrations

We start with the High Court of Justice of England and Wales, King's Bench Division, Commercial Court, and its decision in *Litasco SA v. Der Mond Oil & Gas Africa SA,* [2023] EWHC 2866 (Comm). In that action, a wholly-owned subsidiary of Lukoil sued a Senegalese oil trader for non-payment after Lukoil delivered all of the crude oil called for under their contract.

The defense relied on both the force majeure clause of the contract – which permitted suspension of performance not only when it became impossible but when it became "hindered" by a force majeure event – and a related clause allowing the parties to suspend performance if any sanctions regulations became applicable to either party or to the oil sales themselves. According to the defense, the force majeure clause was triggered by the unavailability of any European clearing bank to process payment, while the sanctions clause was triggered when the United Kingdom imposed sanctions on entities "owned or controlled by" a sanctioned individual (allegedly Lukoil's former CEO and the President of the Russian Federation).

The High Court rejected both defenses. First, while it acknowledged that the force majeure clause appropriately wrote a lesser burden for excused performance into the contract (hindrance, rather than full impossibility), it concluded that the clause nevertheless did not apply because: (i) the unavailability of payments through clearing banks hindered one *means* of performance, not performance (that is, payment) altogether; and (ii) more pointedly, the evidence showed that the true reason for defendant's non-payment was its lack of sufficient currency reserves.

Second, the High Court determined that the sanctions clause did not apply because the defense's allegations that Lukoil was subject to sanctions because of its control by other sanctioned individuals remained speculative.

Next, we turn to *Siemens Energy, Inc. V. Petróleos de Venezuela, S.A.*, 82 F.4th 144 (2023), in which the Second Circuit determined whether sanctions on the Republic of Venezuela excused payment of a loan note under the common law defense of impossibility (rather than, as in *Litasco*, an express force majeure clause).

Plaintiff Dresser-Rand had entered into a $120 million loan note with the state-owned Venezuelan oil giant PDVSA in January 2017. After PDVSA made two payments under the note later that year, the Trump Administration issued a set of sweeping sanctions against Venezuela restricting PDVSA's access to U.S. banking facilities and forbidding, among other things, the financing of "new debt" with PDVSA. After intermediary banks refused to process PDVSA's third payment, the parties agreed to temporarily suspend payment while they sought out alternative means to complete the required funds transfers.

PDVSA, after refusing to make further payment, then cheekily argued that this suspension amounted to the creation of a new debt prohibited by U.S. sanctions, thus making its performance impossible, while also continuing to maintain that the refusal of U.S. banks to process its payments based on their application of their own internal risk assessment factors made payment impossible.

The Second Circuit rejected both arguments. The court had no compunctions against interpreting the scope of the new sanctions of its own accord, determining that no "new debt" was created by Dresser-Rand's agreement to suspend payment, but rather that Dresser-Rand had consented to late payment of an original debt predating and thus remaining outside the scope of sanctions.

With respect to the very real reluctance of U.S. banks to process payments on behalf of sanctioned entities, the court applied that crucial caveat to the impossibility doctrine: that the non-performing party *actually* undertake all legally available steps to accomplish performance by alternative means. Yes, banks had indeed rejected payments by PDVSA: but Dresser-Rand had proposed alternatives that PDVSA ignored, while evidence showed that – in other transactions – PDVSA had managed to find a U.S. bank willing to facilitate its payments. PDVSA's failure to pursue those possible alternatives was in and of itself fatal to its impossibility defense.

Lastly, we examine the federal Central District of California's decision in *Veribi, LLC v. Compass Mining, Inc.*, No. 22-cv-04537, 2023 WL 3555471, at *3 (C.D. Cal. Apr. 20, 2023) – a decision with a similar result, despite a much more direct prohibition on the underlying transaction.

In *Veribi*, a Nevada-based bitcoin miner, Veribi, contracted with a Delaware-based company that provided hosting services for bitcoin mining computers, Compass. Compass in turn sub-contracted with a Russian hosting company, BitRiver, that – as a major player in the Russian technology industry – soon found itself within the scope of Executive Order 14024 after that order issued in 2021. No longer legally able to deal with BitRiver, Compass soon terminated its agreements with that company: a major problem for Veribi, which had purchased 150 miners hosted by BitRiver at Compass' behest in facilities in Russia.

Veribi contacted both Compass and BitRiver seeking the return of its miners. BitRiver declined on the basis it needed authorization from Compass, while Compass declined on the basis that it could no longer conduct business with BitRiver. When Veribi then sued Compass, it defended on the grounds that a return of the miners was impossible so long as BitRiver remained sanctioned.

The court agreed with Compass that it was forbidden from transacting with BitRiver, observing that "any contact Compass had with BitRiver seeking BitRiver's services would have constituted a federal crime." And yet the court emphatically *dis*-agreed that impossibility excused Compass' failure to return the miners to Veribi. How so? Because there were other potential legal means to effectuate their return, including most prominently a license application to the Treasury Department.

Although license applications can be difficult and time-consuming, they provide a legal mechanism to obtain official approval of a transaction that is otherwise squarely and indisputably illegal under United States sanctions. Are license applications impractical? Oftentimes, yes. But are they futile? Absolutely not. Any party faced with a claim that performance is impossible due to United States sanctions, then, should be aware that licenses are available, be prepared to demand that the non-performing party seek one, and – should the matter go to court – raise the absence of a license application as an objection to any defense based on impossibility.

We here at Wilk Auslander continually stay abreast of new developments in cross-border litigation. If you would like to further discuss the latest developments, please reach out to Natalie Shkolnik at (212) 981-2294, nshkolnik@wilkauslander.com or Michael Van Riper at (212) 421-2902, mvanriper@wilkauslander.com.

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