SANCTIONS AND PAYMENT OBLIGATIONS
FROM PROHIBITION TO PERFORMANCE

David Allen KC, Peter Ferrer and Aradhya Sethia of 7 King's Bench Walk Chambers consider the principal English authorities that address the impact of UK and foreign sanctions on contractual payment obligations.

Sanctions sit at the intersection of regulatory compliance and contractual performance. They may determine not only whether parties can lawfully contract with one another, but also whether existing contractual payment obligations can be performed, suspended or performed only with appropriate authorisation. These issues are particularly significant in cross-border transactions, where factors such as the sanctions status and location of the parties, the role of paying, receiving or intermediary banks, the currency of payment, and the relevant clearing route may engage UK, EU, US or other applicable sanctions regimes.

This article considers the leading English cases that examine the effect of UK and foreign sanctions on contractual payment obligations, with a particular focus on the issues likely to arise for UK businesses. These include:

- The scope and operation of UK sanctions law.
- The effect of UK and foreign sanctions on contractual payment obligations.
- The construction and operation of contractual sanctions clauses.
- The interaction between conflicting sanctions regimes.
- The statutory and common law defences available where performance is withheld or delayed.

This remains a fast-developing area and further clarification is likely to emerge as additional cases come before the courts.

UK SANCTIONS LAW

Sanctions are restrictions that are imposed on individuals, businesses or governments to promote foreign policy and national security objectives. A designated person is an individual or entity that is formally listed as subject to sanctions.

The structure and operation of the UK sanctions regime were authoritatively explained by the Supreme Court in *Shvidler v Secretary of State for Foreign, Commonwealth and Development Affairs; Dalston Projects Ltd and others v Secretary of State for Transport* (*[2025] UKSC 30*) (*see box "Supreme Court guidance on the UK sanctions regime"*). The UK sanctions regime is governed principally by the Sanctions and Anti-Money Laundering Act 2018 (2018 Act), which confers broad powers on ministers to impose sanctions.

Supreme Court guidance on the UK sanctions regime

In *Shvidler v Secretary of State for Foreign, Commonwealth and Development Affairs; Dalston Projects Ltd and others v Secretary of State for Transport*, the Supreme Court considered sanctions imposed under the Russia (Sanctions) (EU Exit) Regulations 2019 (*SI 2019/855*) (2019 Regulations). A month after Russia invaded Ukraine, sanctions were imposed on Mr Shvidler, a British citizen with historic ties to the Russian businessman Roman Abramovich, and Dalston Projects Ltd, which held legal title to a yacht that was ultimately beneficially owned by a Russian businessman.

Mr Shvidler and Dalston challenged the sanctions as unlawful on the basis that, among other things, they constituted disproportionate interferences with rights protected under the European Convention on Human Rights. The court upheld the sanctions, concluding that they were lawful and proportionate in light of the objectives of the Russia sanctions regime.

In making its decision, the court explained the UK sanctions regime in broad constitutional and practical terms. In summary, it set out that:

- The court must make its own assessment of whether a sanctions measure is proportionate to a legitimate aim; its role is not limited to checking whether the original decision maker made a legal error, acted irrationally or followed an unfair procedure. However, the court's role is not to substitute its own decision for that of the constitutional decision maker but to assess the proportionality, and therefore legality, of that decision.

- Ministers have special constitutional responsibility and superior institutional competence in matters of foreign affairs, national security and international relations. As a result, the court will accord them a wide margin of judgment when assessing whether sanctions are appropriate and proportionate.

- The sanctions regime is one element of a broader strategy to achieve the UK's foreign policy goals and is deliberately capable of operating cumulatively. For example, in the context of the 2019 Regulations, individual designations or asset restrictions need not, on their own, be shown to change Russia's conduct; they form part of a wider strategy of economic and political pressure.

- In addition to serving an immediate economic purpose, sanctions can also have a deterrent function: for example, by demonstrating to those associated with the Russian business elite that there are consequences for supporting, benefiting from, or legitimising the Russian regime.

Under the 2018 Act, detailed sanctions regimes have been established to target particular jurisdictions and sectors.

A prominent example is the Russia (Sanctions) (EU Exit) Regulations 2019 (*SI 2019/855)* (2019 Regulations), which came into force on 31 December 2020 to encourage Russia to discontinue any actions that would destabilise, undermine or threaten the territorial integrity, sovereignty or independence of Ukraine. The 2019 Regulations were amended following Russia's invasion of Ukraine in February 2022 to expand and strengthen the sanctions, with the aim of intensifying economic pressure on Russia and limiting its ability to support the invasion of Ukraine (*see News brief "Russian sanctions: responding to a complex situation", www.practicallaw.com/w-035-3181 and feature article "Divesting Russian interests: issues for companies", www.practicallaw.com/w-039-7042*). Similar regulations have been made in respect of other jurisdictions.

Types of sanctions

The most commercially significant measures are financial sanctions. These typically prohibit any person from dealing with funds or economic resources that are owned, held or controlled by a designated person, or from making funds or economic resources available, directly or indirectly, to a designated person (*section 3, 2018 Act*). In practical terms, designation ordinarily results in an asset freeze, which prevents the movement, use or transfer of the designated person's assets, and restricts counterparties from performing payment obligations without appropriate licensing.

The 2018 Act also permits the imposition of a range of non-financial sanctions, including director disqualification sanctions, immigration sanctions, trade sanctions, aircraft sanctions and shipping sanctions (*sections 3A-8, 2018 Act*). These measures may operate alongside financial sanctions and can have significant implications for contractual performance and dispute resolution.

For UK businesses, the immediate consequence of a counterparty's designation is that financial dealing with that counterparty will generally require a specific or general licence from the Office of Financial Sanctions Implementation before it can lawfully be performed. The same restriction will often apply where the counterparty is not designated but is owned or controlled by a designated person (*see below*).

Ownership and control test

An issue that has been frequently litigated since the 2019 Regulations came into force is the meaning and scope of the ownership and control test. Regulation 11 of the 2019 Regulations prohibits dealing with funds or economic resources that are owned, held or controlled by a designated person. Regulation 12 of the 2019 Regulations prohibits making funds or economic resources available, directly or indirectly, to a designated person. Critically, these prohibitions extend beyond formally designated persons. A non-designated entity will be subject to sanctions if it is owned or controlled, directly or indirectly, by a designated person.

The meaning of ownership and control is addressed in regulation 7 of the 2019 Regulations (regulation 7). The courts have emphasised that this is a question of fact, which requires proof rather than suspicion. In *Vneshprombank LLC v Bedzhamov*, the High Court rejected the contention that sanctions could be engaged merely where there was reasonable cause to suspect ownership or control by a designated person (*[2024] EWHC 1048 (Ch)*). It held that the statutory test requires ownership or control to be established in fact. This distinction is of practical importance, as counterparties frequently seek to justify non-performance by reference to sanctions risks in circumstances where ownership or control has not been established.

The scope of the control test was considered in *PJSC National Bank Trust and another v Mints and others* (*[2023] EWHC 118 (Comm)*). The High Court observed, obiter, that control exercised through political office, as opposed to corporate office, would not without more suffice to establish control for sanctions purposes. On appeal, the Court of Appeal declined to endorse that limitation and emphasised that the language of regulation 7 does not recognise any distinction between political and corporate control (*[2023] EWCA Civ 1132; see Briefing "UK sanctions framework: the complexities of the control test", www.practicallaw.com/w-042-4306*). It observed that "Mr Putin is at the apex of a command economy", so he "could be deemed to control everything in Russia". While these observations were obiter, they illustrate the potential breadth of the statutory concept of control.

Further guidance was provided in *Litasco SA v Der Mond Oil and Gas Africa SA and another,* where the defendant companies resisted paying the claimant, Litasco SA, for Nigerian crude oil on the basis that, although Litasco was not designated, it was allegedly controlled by President Putin and payment to it would therefore breach sanctions (*[2023] EWHC 2866 (Comm)*). The High Court rejected that argument. It emphasised that the central focus of the control inquiry is the ability of the designated person to control how the funds are used. On the facts, the court found no arguable basis for suggesting that the funds received by Litasco would be used in accordance with President Putin's wishes, describing that suggestion as "wholly improbable".

Taken together, these authorities establish that the ownership and control test is a fact-sensitive inquiry that is directed at the existence of actual control over the use or disposition of funds or economic resources. While the Court of Appeal's observations in *Mints* underscore the potentially wide scope of the statutory language, as clarified by the High Court in *Litasco*, mere political influence or bare assertions of state control may not suffice, especially where the relevant person is a private entity.

The practical implication of the *Litasco* approach for a UK business is that suspicion alone is unlikely to support a decision to withhold performance. Equally, the breadth of the test as articulated in *Mints* means that financial institutions cannot rely on the absence of formal designation to clear payments. However, in the absence of any binding appellate authority, the precise boundaries of the concept remain uncertain.

PAYMENT OBLIGATIONS

Sanctions issues often become most acute in the context of contractual payment obligations. Even where an underlying contract remains valid, sanctions may affect whether a payment can lawfully be made, whether the obligation is suspended pending a licence, or whether non-payment can be justified by reference to the relevant statutory regime or contractual terms. The cases considered below illustrate that the position depends heavily on the precise wording of the applicable sanctions provisions, the availability of any licensing mechanism and the contractual terms governing payment.

A broad construction

The Supreme Court's decision in *Celestial Aviation Services Ltd v UniCredit Bank GmbH, London Branch* provides important guidance on how UK sanctions may affect contractual payment obligations, particularly in the context of letters of credit (*[2026] UKSC 10; see News brief "Sanctions on finance arrangements: Supreme Court confirms broad scope", www.practicallaw.com/w-050-0536*).

The claim in *Celestial Aviation* arose out of aircraft leasing arrangements between Irish lessors and Russian airlines. In connection with those leases, the lessors held US dollar-denominated letters of credit that were issued by a Russian bank, Sberbank, which later became a designated person under the 2019 Regulations. UniCredit Bank GmbH, acting through its London branch, was the confirming bank under the letters of credit. Following the Russian invasion of Ukraine, the lessors terminated the leases and made demands for payment from UniCredit. UniCredit refused to pay but applied for licences to permit the payments. It contended that its obligation to pay was prohibited by the 2019 Regulations regime until the licences were obtained.

The High Court held that UniCredit's payment obligation was not prohibited (*[2023] EWHC 663 (Comm); www.practicallaw.com/w-039-2356*). It reasoned that payment to the lessors, which were not designated persons, would not facilitate the supply of aircraft to Russia, particularly as the leases had been terminated and the aircraft had already been delivered before the imposition of sanctions.

The Court of Appeal allowed the appeal (*[2024] EWCA Civ 628; see Briefing "Dispute resolution in financial services: scanning the horizon for key trends", www.practicallaw.com/w-045-6129*). It emphasised that the relevant sanctions provisions must be interpreted purposively in light of their broader objective of exerting economic pressure on Russia. In particular, it described regulation 28(3) of the 2019 Regulations (regulation 28(3)) as a "relatively blunt instrument" that was intended to operate broadly rather than narrowly, and "to cast the net sufficiently wide to ensure that all objectionable arrangements are caught". The court rejected the argument that the sanctions regime was concerned only with preventing future supplies of aircraft to Russia. It held that the performance of UniCredit's payment obligations was affected by the 2019 Regulations, and that those obligations were suspended unless and until an appropriate licence was obtained.

The Supreme Court upheld this broad reading. It agreed that regulation 28(3)(c) was designed to cast the net wide, with the licensing regime available to mitigate any unintended consequences. The court held that this structure reflected the important public interests engaged by sanctions and the institutional competence of public authorities to decide, through the licensing process, whether a transaction should be permitted. It also held that regulation 28(3)(c) does not require a causative connection between the provision of financial services or funds and the prohibited supply; it is sufficient that the financial services or funds are provided in connection with an arrangement whose object or effect is to make restricted goods or technology available.

A narrow construction

The High Court's decision in *AerCap Ireland Ltd v AIG Europe SA and others* provides an important contrast with the Court of Appeal's approach in *Celestial Aviation* and illustrates a narrower approach to construing sanctions prohibitions in circumstances where the relevant legislation did not include a licensing mechanism (*[2025] EWHC 1430 (Comm)*).

The claims in *AerCap* arose under war risks insurance policies that were issued to aircraft lessors. The relevant sanctions were the aviation-sector restrictions in Article 3c of the Regulation concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine (*833/2014/EU*) (2014 Regulation) (Article 3c), which applied to insurance and financial assistance relating to aircraft and aviation goods supplied to, or for use in, Russia. Following the imposition of these sanctions, the lessors issued termination notices to lessee Russian airlines and requested the redelivery of the lessors' aircraft and engines. Many of the Russian airlines did not comply. The lessors claimed under their insurance policies on the basis that the aircraft were lost.

The insurers denied liability and argued that any indemnity paid to the lessors would indirectly benefit Russian airlines and therefore contravene Article 3c. The High Court rejected the insurers' argument. It held that the insureds were non-Russian lessors, and that indemnifying them would not constitute the provision of insurance services to a "person, entity or body in Russia or for use in Russia" under the 2014 Regulation.

AerCap illustrates the importance of the specific structure and language of the sanctions regime in question. Unlike the UK sanctions considered in *Celestial Aviation*, the EU provisions in *AerCap* did not incorporate a licensing regime that permitted otherwise prohibited conduct to be authorised in appropriate circumstances. The absence of such a mechanism informed the court's interpretation. It held that, in these circumstances, a purposive interpretation did not justify extending the scope of the prohibition beyond its natural meaning; on the contrary, the legislative scheme supported a narrower construction of the relevant restrictions.

The role of licensing mechanisms

Taken together, *Celestial Aviation* and *AerCap* demonstrate that the effect of sanctions on contractual payment obligations depends critically on the precise language of the prohibition, the existence of licensing mechanisms and the underlying legislative purpose. The contrast between *Celestial Aviation* and *AerCap* matters most for UK businesses whose operations straddle UK and EU regimes. Where the relevant UK regime contains a licensing mechanism, the court is likely to construe the prohibition broadly; where the relevant EU regime contains no such mechanism, a narrower construction is more likely.

Alternative payment arrangements

English case law illustrates that the courts will not readily require a party to accept non-contractual performance unless the contract clearly provides for it. When entering into a contract containing payment obligations, parties seeking to preserve payment continuity in the face of potential sanctions should:

- State expressly whether payment may be made in an alternative currency.
- Specify the conversion date, exchange rate source and which party will bear any exchange losses.
- Provide for alternative bank accounts or payment routes.
- Include a co-operation obligation requiring parties to take steps to resume lawful payment.
- Address whether substitute performance discharges the original payment obligation.
- Provide for licence applications and allocate responsibility for the costs of doing so.
- Clarify whether the imposition of sanctions would suspend performance, excuse liability or trigger termination.

SANCTIONS CLAUSES

In addition to statutory prohibitions, sanctions frequently affect payment obligations through the operation of contractual sanctions clauses. The English courts have considered how contracts should be construed where sanctions affect the performance of payment obligations.

Non-contractual performance

The Supreme Court's decision in *RTI Ltd v MUR Shipping BV* provides significant guidance on the effect of sanctions on contractual payment obligations (*[2024] UKSC 18; see News brief "Force majeure and reasonable endeavours: Supreme Court provides certainty", www.practicallaw.com/w-043-4209*).

RTI Ltd and MUR Shipping BV entered into a contract of affreightment that required freight to be paid in US dollars. The contract included a force majeure clause that suspended the parties' obligations where a force majeure event occurred and the affected party could not overcome the event or circumstances through reasonable endeavours (*see feature article "Force majeure in a changing world: predicting the unpredictable", www.practicallaw.com/w-019-2821*).

Following the imposition of US sanctions on RTI's parent company, MUR invoked the force majeure clause, contending that the sanctions prevented lawful payment in US dollars. RTI proposed to pay in euros instead and offered to indemnify MUR against any exchange rate losses. MUR refused that proposal and maintained that the force majeure clause suspended its obligation to perform.

The central issue was whether the reasonable endeavours clause obliged MUR to accept RTI's offer of payment in euros, despite the contractual requirement for payment in US dollars. The Supreme Court emphasised that the object of a reasonable endeavours obligation is to overcome the impediment to performing the contractual bargain, not to substitute a different form of performance. It held that reasonable endeavours do not require the acceptance of an offer of non-contractual performance without clear wording to that effect.

By contrast, where the contract expressly provides for co-operation or alternative arrangements to overcome the consequences of sanctions, the court may require parties

Drafting sanctions clauses

Mamancochet Mining Ltd v Aegis Managing Agency Ltd and others provides important practical guidance in relation to the drafting of sanctions clauses (*[2018] EWHC 2643 (Comm)*). In particular, parties should consider whether the clause will:

- Be triggered only by an actual prohibition or by a reasonable risk that performance may expose a party to sanctions. Parties should use clear wording to distinguish between "would expose" and broader formulations such as "may expose" or "could reasonably be expected to expose".
- Operate as an exclusion of liability, a suspension of performance or a termination right.
- Include a right or an obligation to apply for a licence before the sanctions clause is invoked, with responsibility for the costs of doing so clearly allocated.

The Court of Appeal provided further guidance on the trigger wording in *Tonzip Maritime (Singapore) Pte Ltd v 2 Rivers Pte Ltd (The Catalan Sea)* (*[2026] EWCA Civ 641; www.practicallaw.com/w-050-5180*). The sanctions clause entitled the shipowners to refuse to comply with voyage orders that, in their "reasonable judgment", were either prohibited by sanctions or would expose the shipowners to sanctions. The court held that the wording "will expose...[the shipowners]...to sanctions" required only an objectively reasonable judgment that performance carried a real risk of a sanctions breach, not proof on the balance of probabilities that sanctions would in fact be contravened.

The Catalan Sea also highlights that the commercial context is important. The court distinguished *Mamancochet*, in part, because it concerned a payment obligation under an insurance policy, which the insurer could assess after the event, with time and full knowledge of the relevant facts. By contrast, a shipowner, as in *The Catalan Sea*, must judge a voyage order prospectively "in the heat of the moment".

to accept non-contractual performance. In *Gravelor Shipping Ltd v GTLK Asia M5 Ltd*, the charterparty required the parties to "co-operate and promptly take necessary steps in order for the payments to be resumed" where Russia sanctions prevented payment (*[2023] EWHC 131 (Comm)*). The High Court held that this wording required the recipient party to nominate an alternative bank account and accept payment in euros instead of US dollars in order to facilitate lawful performance.

In the absence of a clear contractual provision addressing alternative currencies, substitute performance or sanctions-related contingencies, a party will not ordinarily be required to accept performance that differs from that contractually agreed, even if it is economically equivalent. The courts will not readily imply an obligation to accept substitute performance solely to mitigate the effects of sanctions. However, where the contract expressly requires the parties to co-operate or take reasonable steps to overcome sanctions-related impediments, the court may require them to accept alternative performance in order to facilitate lawful performance. Ultimately, the question is one of contractual construction.

Therefore, without express wording, a payee cannot be compelled to accept non-contractual performance, even where this is the only way to facilitate lawful payment. Effective drafting would typically provide for an express co-operation provision, as provided in *Gravelor*, or a currency substitution clause that specifies the conversion mechanism and cost allocation of any such conversion (*see box "Alternative payment arrangements"*).

Exposure to sanctions clauses

The construction of contractual sanctions clauses was also considered in *Mamancochet Mining Ltd v Aegis Managing Agency Ltd and others* (*[2018] EWHC 2643 (Comm)*). Mamancochet Mining Ltd was the assignee of the benefit of a marine cargo insurance policy. The policy contained a sanctions clause providing that the insurer would not be liable to pay any claim where payment "would expose that insurer to any sanction, prohibition or restriction" under applicable sanctions laws or regulations.

A $3.8 million cargo was stolen from a warehouse in Iran. The consignee of the cargo was an Iranian national. At the time of the claim in March 2013, EU and US sanctions were in force against Iran. The sanctions were later relaxed. Mamancochet sought to claim under the policy but the defendant underwriters resisted payment on the basis of the exposure to sanctions clause.

The High Court held that the clause required the underwriters to establish, on the balance of probabilities, that payment would in fact be prohibited by the applicable sanctions regime, and would therefore expose them to a sanction, prohibition or restriction. It was not enough to show that there was a mere risk of such exposure. The relevant question was whether payment would constitute "conduct which was prohibited by the applicable laws or regulations". On the facts, the underwriters were unable to discharge that burden.

The court also held that, while payment would have been prohibited in 2013, the underwriters could not show that payment was prohibited once the sanctions were relaxed. The exposure to sanctions clause therefore suspended the payment obligation, but did not permanently extinguish Mamancochet's claim.

Mamancochet confirms that sanctions clauses are construed strictly in accordance with their terms. A party relying on a sanctions clause must demonstrate that performance would be prohibited by applicable sanctions, rather than merely commercially undesirable or legally uncertain due to sanctions risk (*see box "Drafting sanctions clauses"*).

CONFLICTING REGIMES

Sanctions issues are particularly complex where more than one sanctions regime may apply to the same payment obligation. A payment obligation that is governed by English law may nevertheless involve US dollar clearing, US correspondent banks, EU counterparties or foreign sanctions designations. In those circumstances, one regime may make payment unlawful or expose a party to sanctions risk, while another may restrict reliance on that foreign law as a reason for non-performance.

UK Blocking Regulation

One source of potential conflict is the retained EU law version of the Blocking Regulation (*2271/96/EC*) (UK Blocking Regulation), which may be relevant where a UK party refuses to perform a contract in order to comply with foreign sanctions. Article 5 of the UK Blocking Regulation prohibits UK persons from complying, directly or indirectly, with specified extraterritorial sanctions imposed by third countries, principally certain US sanctions regimes relating to Cuba and Iran. It also provides a mechanism for the recovery of damages arising from prohibited compliance. In these circumstances, parties may face conflicting legal obligations, particularly where contractual performance engages US sanctions exposure while UK law prohibits compliance with those same sanctions.

This issue was considered, albeit obiter, in *Mamancochet* in the context of the Blocking Regulation, as the decision predated Brexit. Mamancochet argued that, by relying on the exposure to sanctions clause to refuse payment, the underwriters were in effect complying with US extraterritorial sanctions in breach of the Blocking Regulation. The court did not determine this issue, but observed that there was considerable force in the underwriters' argument that reliance on a contractual provision that suspends liability where payment would expose the relevant party to sanctions does not amount to compliance with foreign sanctions for the purposes of the Blocking Regulation. This suggests that the operation of the contractual provisions may, in principle, be distinguished from voluntary compliance with foreign sanctions.

More recently, limited guidance was provided by the High Court in *Beneathco DMCC v RJ O'Brien Ltd* (*[2025] EWHC 3079 (Comm); www.practicallaw.com/w-049-2893*). Beneathco DMCC was a Dubai-based petroleum trading company that had been designated as a sanctioned entity by the US in January 2020. At that time, a finance broker, RJ O'Brien Ltd, held $16.5 million of Beneathco's funds in UK and US bank accounts.

Following designation, Beneathco instructed O'Brien to transfer the funds into another currency or to a third party. O'Brien refused on the basis that processing the instruction would cause the relevant US correspondent bank to breach US sanctions law. Beneathco argued, among other things, that the UK Blocking Regulation prevented O'Brien from relying on US law as a justification for non-performance.

The court rejected this argument. It held that the UK Blocking Regulation was intended to prevent UK persons from complying with extraterritorial foreign legislation. On the facts, O'Brien's performance would have required conduct within the US that was unlawful under US law. It concluded that this fell outside the scope of the UK Blocking Regulation. However, the court did leave open the possibility that the UK Blocking Regulation could apply where O'Brien's own instructions within the UK were the sole reason for non-performance of its contractual obligations.

Beneathco therefore suggests that the UK Blocking Regulation is less likely to be engaged where non-performance is driven by the operation of US law on activity that genuinely takes place within the US, such as through a US correspondent bank, than where a UK party simply chooses to follow US sanctions guidance as a matter of its own commercial policy.

While *Beneathco* provides useful guidance, the UK Blocking Regulation has not yet received detailed consideration by the English courts. The issue arose more directly in *Virgo Marine and another v Reed Smith LLP*, where Reed Smith LLP has pleaded, among other things, that Barclays Bank's refusal to process a payment on the basis of US sanctions breached the UK Blocking Regulation (*[2025] EWHC 1157 (Comm)*). The case is listed for trial in 2026 and may provide the first substantive English authority addressing the interaction between the UK Blocking Regulation and contractual payment obligations.

US secondary sanctions

The Court of Appeal's decision in *Lamesa Investments Ltd v Cynergy Bank Ltd* provides important guidance on the effect of US secondary sanctions on contractual payment obligations governed by English law (*[2020] EWCA Civ 821*).

Cynergy Bank Ltd had entered into a loan agreement with Lamesa Investment Ltd. Following the imposition of US sanctions on Lamesa's ultimate owner, Mr Viktor Vekselberg, Lamesa was treated as a blocked person under US law. Although Cynergy was a non-US person, it maintained correspondent banking arrangements in US dollars. As a result, making payment to Lamesa exposed Cynergy to the risk of US secondary sanctions, including restrictions affecting its ability to access the US financial system.

The loan agreement contained a provision suspending Cynergy's payment obligation where non-payment was required in order to

The *Ralli Bros* defence in practice

Where a party seeks to rely on foreign illegality as a defence to non-payment, it should:

- Identify the foreign sanctions law that allegedly makes performance unlawful.
- Demonstrate that performance necessarily requires an unlawful act in the foreign jurisdiction.
- Analyse whether the illegality affects the payer, the receiving bank, the intermediary bank, the correspondent bank or another third party.
- Check whether the relevant sanctions regime permits a licence to be obtained.
- Apply promptly for any available licence.
- Frame the licence application so that it addresses the precise contractual payment obligation.
- Keep evidence of any legal advice, bank correspondence, licence applications and regulator responses.
- Be prepared to prove that a licence application would have been futile if no application was made.

comply with "any mandatory provision of law, regulation or order of any court of competent jurisdiction" (the suspension clause). Cynergy relied on the suspension clause to justify its refusal to make payment.

The Court of Appeal upheld Cynergy's reliance on the suspension clause. It rejected Lamesa's argument that the suspension clause applied only where payment was directly prohibited and held that US secondary sanctions could fall within the scope of the suspension clause, even though they did not expressly prohibit payment. The court emphasised that the relevant US legislation imposed mandatory legal consequences on non-US persons that engaged in prohibited dealings, including sanctions affecting their US operations. This was sufficient to constitute a "mandatory provision of law" within the meaning of the suspension clause.

A key practical drafting lesson for UK businesses is the importance of defining the scope of any "mandatory provision of law" clause with sufficient breadth. If the clause is drafted broadly enough, it may allow a party to suspend payment where performance would expose it to US secondary sanctions, even where those sanctions do not directly prohibit performance. However, drafting that limits the clause to the laws of England or another defined territory will rule out reliance on US secondary sanctions and leave the party without this contractual defence.

Practical implications

The combined effect of *Lamesa, Mamancochet* and *Beneathco* frames a real and recurring problem for UK businesses; that is, being caught between exposure to foreign sanctions, particularly US sanctions, on the one hand and UK law that prohibits compliance with those same foreign sanctions on the other. Where a party is assessing whether it may lawfully refuse payment due to foreign sanctions without breaching the UK Blocking Regulation, the key question after *Beneathco* is the nature of the operative act giving rise to the non-performance. If the relevant conduct occurs in the foreign jurisdiction whose sanctions are engaged, the UK Blocking Regulation may not apply.

TWO DEFENCES

There are two general defences that are particularly relevant where a party withholds or delays the performance of a payment obligation because of sanctions: the statutory defence under section 44 of the 2018 Act (section 44) and the common law defence known as the *Ralli Bros* principle (*Ralli Bros v Compañia Naviera Sota y Aznar [1920] 2 KB 287*).

Section 44

Section 44 provides an important statutory protection for persons that act in compliance, or purported compliance, with sanctions. It provides that a person is "not liable to civil proceedings" for acts done or omitted in the reasonable belief that the act or omission was in compliance with sanctions.

The scope of the defence was considered by the Supreme Court in *Celestial Aviation*. Although it was unnecessary to decide the point conclusively, the court nonetheless provided guidance on section 44 given that it was likely to affect a significant number of other cases.

The court clarified that section 44 does not prohibit civil proceedings; rather, it provides a defence in civil proceedings. Moreover, its protection extends to proceedings that are concerned with an action to recover a debt, an award of interest or an award of associated costs.

The defence contains both a subjective and an objective element: the person must have actually believed that their conduct was compliant with sanctions, and that belief must have been reasonable. The assessment of reasonableness must be undertaken in the light of the novelty and complexity of the legislation, the speed at which compliance judgments must often be made, and the serious consequences of even an inadvertent breach.

Although they are obiter, these clarifications are particularly significant for parties that refuse to perform contractual obligations where sanctions are engaged or reasonably perceived to be engaged. As a practical matter, it would be advisable for parties to maintain a documentary record of the advice or information on which they based their decision to refuse payment.

Ralli Bros defence

As mentioned above, sanctions issues frequently arise where contractual payment obligations that are governed by English law intersect with foreign sanctions regimes, particularly where payment in US dollars requires processing through the US financial system (*see "Conflicting regimes" above*). The relevant common law rule is the *Ralli Bros* principle.

As a general rule, the English courts will determine the enforceability of a contract governed by English law without reference to any illegality under foreign law. The *Ralli Bros* principle provides a limited exception where contractual performance necessarily requires an act to be done in a place where it would be unlawful to carry out that act.

For the *Ralli Bros* principle to apply, it is not necessary that the unlawful act is carried out by the defendant; it may also apply to third-party illegality. For example, the processing of a defendant's payment instruction in US dollars may involve a breach of foreign law by the correspondent US bank (*Beneathco)*.

Two cases provide guidance on how English law responds to this issue in the sanctions context.

Banco San Juan. In *Banco San Juan Internacional Inc v Petróleos De Venezuela SA,* Petróleos De Venezuela SA argued that US sanctions rendered unlawful and excused its non-payment under English law-governed credit agreements (*[2020] EWHC 2937 (Comm)*). The High Court rejected that argument and held that the *Ralli Bros* principle is narrow and applies only where performance necessarily requires an act to be done in a place where that act would be unlawful. It is not enough that performance is made more difficult or exposes the party to sanctions risk.

Where the relevant sanctions regime includes a licensing mechanism, the party relying on foreign illegality must make reasonable efforts to obtain a licence, or prove that any such application would have been futile. Petróleos De Venezuela had not done so. The court therefore concluded that a party is not excused from performance "unless and until they make reasonable efforts to apply for and are refused a licence, or prove that, even had such efforts been made, a licence would actually have been refused".

Celestial Aviation. The Court of Appeal endorsed and applied this reasoning in *Celestial Aviation*. UniCredit argued that the performance of its obligation to pay under US dollar-denominated letters of credit would engage US sanctions, potentially bringing the case within the *Ralli Bros* principle. While the court accepted that the *Ralli Bros* principle may be engaged where contractual performance necessarily requires an unlawful act in a foreign jurisdiction, it held that UniCredit could not rely on that principle because it had failed, in the particular circumstances of the case, to make reasonable efforts to obtain a licence from the relevant US authorities. Although UniCredit did make a licence application, it was framed in a manner that did not properly address the relevant payment obligations, and therefore did not satisfy the requirement to take reasonable steps to overcome the prohibition.

Application in practice. In addition to providing helpful clarification on the application of the *Ralli Bros* principle in the context of sanctions, *Banco San Juan* and *Celestial Aviation* also suggest that factual disputes concerning the obtaining of licences under sanctions regimes may become more prominent in commercial litigation. Where a sanctions regime permits a party to apply for licences, the application of the *Ralli Bros* principle will likely turn on factual evidence as to whether that party has taken reasonable steps to obtain a licence, or on expert evidence as to whether such efforts would have been futile. For example, in *Beneathco,* after examining the respective expert witnesses, the court held that the defendant, O'Brien, had satisfied the burden that it had taken reasonable steps to obtain a licence.

Ralli Bros remains the principal common law defence available to a UK party whose performance would require an unlawful act in a foreign jurisdiction. From the perspective of a financial institution, this defence is most likely to be invoked in the processing of US dollar payments. At the same time, this defence has its limits. Parties should carefully consider whether a licence could be obtained and take reasonable steps to obtain one. They must file a licence application promptly and frame it carefully so that it addresses the specific payment obligation in issue since, as *Celestial Aviation* illustrates, a poorly framed application can defeat the defence even where there is a likely exposure to sanctions (*see box "The Ralli Bros defence in practice"*).

David Allen KC, Peter Ferrer and Aradhya Sethia are barristers at 7 King's Bench Walk Chambers.

Related information

This article is at practicallaw.com/w-050-5867

Other links from uk.practicallaw.com/

Topics

Executive and legislative powers	topic/8-614-6865
General contract and boilerplate	topic/9-103-1119
International individuals	topic/5-383-2285
International trade	topic/8-103-2044
Sanctions and export control	topic/6-638-9039

Practice notes

Contracts: discharge of contracts	2-107-4876
Contracts: force majeure	7-380-6134
Contracts: interpretation	3-508-7082
Financial sanctions	5-607-4445
Financial sanctions: implications for financial institutions	6-375-2155
Impact of sanctions on arbitration	w-030-4886
Russia sanctions and related considerations: key issues for corporate lawyers	w-034-8118
Russia sanctions: UK legislation tracker	w-034-7701
Sanctions and Anti-Money Laundering Act 2018: overview	w-015-4069
Sanctions: challenging UK, UN and EU designations	w-014-5092
Sanctions regime: overview (UK)	w-035-2784
Sanctions risk: compliance roadmap (UK)	w-035-5757
UK financial sanctions: law firm compliance	w-034-3856

Previous articles

The UK's anti-corruption revolution: rewriting the rules for businesses (2026)	w-050-1263
Divesting Russian interests: issues for companies (2023)	w-039-7042
Drafting contracts: recent cases and key lessons (2023)	w-039-0728
Force majeure in a changing world: predicting the unpredictable (2019)	w-019-2821
Limiting liability in contracts: lessons to be learned (2018)	w-012-9115
Terminating for breach of contract: look before you leap (2018)	w-016-9676
Breaches of financial sanctions: a focus on voluntary disclosure (2017)	w-009-2301
Endeavours clauses: striving for certainty (2017)	w-007-9797

For subscription enquiries to Practical Law web materials please call +44 0345 600 9355