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Impact of Sanctions on Contracts

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Corporate, Litigation, International Trade Controls

In the wake of Russia's invasion of Ukraine, the United States, the European Union, the United Kingdom and other countries around the world have imposed a series of wide ranging sanctions with respect to Russia and Belarus. They include property-blocking sanctions and asset freezes with regard to designated entities, restrictions on transactions or other dealings with certain entities, and other measures. The sanctions can apply with considerable extraterritorial effect and, consistent with their purpose, often seek to reach conduct that might be viewed as indirectly aiding sanctioned conduct or that has the purpose or effect of circumventing a prohibition.

This alert highlights the issues that can arise when sanctions affect commercial contracts under New York, English and German law, with a particular focus on situations where a contract was valid at formation but performance is subsequently impeded by an intervening sanction. Understanding these impacts often requires recourse to basic principles of contract law -- such as *illegality*, *impossibility*, *impracticability* and *frustration of purpose* -- which may operate very differently across jurisdictions.

A review of the case law in this area shows the varied fact patterns that can arise and how the application of seemingly simple principles can be surprisingly complicated in practice. That is particularly true in an international context where conduct may be sanctioned under the laws of a jurisdiction other than the governing law of the contract. Further complexities emerge when a blocking statute seeks to preempt the effects of foreign sanctions.

Cross-border contracts often will have specific terms addressing force majeure and sanctions compliance. Relevant cases will be highly dependent on the specific language of the contract terms. Applicable law may limit parties' ability to agree to comply with foreign embargos. Sanctions and blocking statues may contain "saving clauses" to address the consequences of non-performance, and the excuse or discharge of performance may give rise to claims for damages or unjust enrichment. These and other issues will need to be considered carefully in specific cases and are beyond the scope of this alert.

I. NEW YORK

Whether an agreement that contravenes applicable law is enforceable under New York law depends on the purpose of the relevant law, the extent to which the contemplated conduct has a direct connection to the prohibition, and whether there are other penalties to redress the violation. Cases where performance becomes illegal after formation of the contract due to intervening government action may also be viewed through the lens of impossibility, impracticability or frustration of purpose. Courts and arbitral tribunals will consider whether

performance has actually become impossible and whether the relevant governmental intervention was anticipated or foreseeable before excusing performance.

A. Illegality

Under New York law, illegal contracts or contracts against public policy are generally not enforceable, although this is not a *per se* rule and courts have discretion to determine whether to enforce such contracts. "[C]ontracts that offend the underlying purpose of a statute are unenforceable." *Cary Oil Co., Inc. v. MG Refining & Mrktg, Inc.*, 230 F.Supp.2d 439, 451 (S.D.N.Y. 2002) (citing *United States v. Mississippi Valley Generating Co.*, 364 U.S. 520, 563 (1961)). While illegal contracts are generally unenforceable, contracts may not be avoided where there are regulatory sanctions or statutory penalties in place to redress violations of law. *See Agarwal v. Sandy Dalal, Ltd.*, 2006 WL 2621048, at *7 (D. Neb. Sept. 12, 2006) (applying New York law) (a debt agreement designed for unwarranted tax deduction was deemed not unenforceable).

Contracts that are otherwise legitimate may be rendered unenforceable by their "direct connection" with an illegal transaction. *Nat'l Petrochemical Co. of Iran v. M/T Stolf Sheaf*, 930 F.2d 240, 241 (2d Cir. 1991) (contracts were "part and parcel" of a larger plan to violate a U.S. trade embargo). There must "at least be a direct connection between the illegal transaction and the obligation sued upon" to excuse performance, and illegalities that are "merely incidental to the contract" are not sufficient to render a contract unenforceable. *McConnell v. Commonwealth Pictures Corp.*, 7 N.Y.2d 465, 471 (1960). Violations of foreign laws may be taken into account. *Nameh v. Muratex Corp.*, 34 Fed.App. 808, 810 (2d Cir. 2002) (illegality of a contract barred claims for relief because defrauding foreign authorities was "necessary to ensure the profitability" of the venture).

B. Impossibility

In New York, impossibility excuses a party's performance only when the destruction of the subject matter of the contract or the means of performance makes performance *objectively* impossible. In addition, performance must have been rendered impossible by an unanticipated event that could not have been foreseen or guarded against in the contract. The doctrine is applied narrowly "due in part to [the] judicial recognition that the purpose of contract law is to allocate the risks that might affect performance and that performance should be excused only in extreme circumstances." *Kel Kim Corp. v. Cent. Markets, Inc.*, 70 N.Y.2d 900, 902 (1987).

To establish the affirmative defense of impossibility due to intervening governmental action, a party must show that the action was not foreseeable, *RW Holdings, LLC v. Mayer*, 131 A.D.3d 1228, 1230 (2d Dep't 2015); *A & S Transp. Co. v. Cty. of Nassau*, 154 A.D.2d 456, 459 (2d Dep't 1989), and rendered performance under the contract impossible. *See Organizacion JD Ltda. v. U.S. Dep't. of Justice*, 18 F.3d 91, 95 (2d Cir. 1994) (holding that intervening government actions seizing money transfers allegedly involved in the proceeds of illegal drug trafficking rendered any enforceable contract impossible to perform); *Hamilton Rubber Mfg. Co. v. Greater New York Carpet House*, 47 N.Y.S.2d 210, 211 (Sup. Ct. N.Y. Cnty. 1944), *aff'd* A.D. 681 (1st Dep't 1945) (recognizing impossibility defense to a breach of contract when the

government prohibited the completion of a contract and the War Production Board refused permission for the party to perform under the contract).

Perhaps unsurprisingly, courts have not looked favorably on cases where a sanctioned party has sought to be excused from payment obligations on preexisting debts when sanctions have rendered payment difficult, but not actually impossible. *See, e.g.*, *Red Tree Invs. LLC v. Petroleos de Venezuela*, 2021 WL 6092462, at *1 (S.D.N.Y. Dec. 22, 2021) (rejecting impossibility defense where payment difficulty was attributable to banks' "risk adversity" rather than illegality of payment; the sanctioned debtor had not taken "every action within its power" to perform its duties; payment was ultimately made after the noteholder pressured the bank, and sanctions were foreseeable and could have been guarded against in the note agreement); *Dresser-Rand Co. v. Petroleos de Venezuela, S.A.*. 2021 WL 5831766, at *8-10 (S.D.N.Y. Dec. 8, 2021) (rejecting impossibility defense when some commercial banks that were not barred by sanctions could complete the transaction).

C. Impracticability

For contracts for the sale of goods, New York's Uniform Commercial Code ("UCC") § 2-615 codifies the doctrine of commercial impracticability in New York. NY UCC § 2-615 "excuses a seller from timely delivery of goods contracted for, where his performance has become commercially impracticable because of unforeseen supervening circumstances not within the contemplation of the parties at the time of contracting." McKinney's Uniform Comm. Code § 2-615. *See also Cliffstar Corp. v. Riverbend Products, Inc.*, 750 F. Supp. 81, 85 (W.D.N.Y. 1990) (holding that in order to succeed on a claim of impracticability under UCC § 2-615, "the party must show that the unforeseen event upon which excuse is predicated is due to factors beyond the party's control").

The breaching party must show a "contingency, the impracticability of performance as a consequence of the occurrence of that contingency, and that the nonoccurrence of the contingency was a basic assumption of that contract." *Dell's Maraschino Cherries Co., Inc. v. Shoreline Fruit Growers, Inc.*, 887 F.Supp.2d 459, 478 (E.D.N.Y. 2012) (applying New York law). Subsection 4 of the Official Comment to NY UCC § 2-615 cautions that "[i]ncreased cost alone does not excuse performance unless the rise in cost is due to some unforeseen contingency which alters the essential nature of the performance . . . . But a severe shortage of raw materials or of supplies due to a contingency such as war, *embargo*, local crop failure, unforeseen shutdown of major sources of supply or the like, which either causes a marked increase in cost or altogether prevents the seller from securing supplies necessary to his performance, is within the contemplation of this section." *Id.* (emphasis added).

In one case, the Second Circuit affirmed a defense of impracticability where an American company that manufactured radio communication products had contracted with another entity to serve as its exclusive distributor of products to Iran. After the goods were seized by U.S. Customs Service officials, the manufacturer agreed to voluntarily withdraw from all further sales to the Iranian market after negotiations with the government, and the distributor sued for breach of contract. The Second Circuit affirmed the district court's ruling that the manufacturer had sufficiently pled the affirmative defense of commercial impracticability, because the case involved "overwhelming and uncontradicted evidence that the government would not allow [the manufacturer] to continue sales to Iran" and there was no evidence that the company acted in bad faith. The company established the affirmative defense when it "complied in good faith with

the government's informal requirements." *Harriscom Svenska, AB v. Harris Corp.*, 3 F.3d 576, 578-580 (2d Cir. 1993).

D. Frustration of Purpose

In New York, the doctrine of frustration of purpose is "a narrow one." *Crown It Services v. Koval–Olsen*, 11 A.D.3d 263, 265 (1st Dep't 2004). "In order to invoke the doctrine of frustration of purpose, the frustrated purpose must be so completely the basis of the contract that, as both parties understood, without it, the transaction would have made little sense." *Warner v. Kaplan*, 71 A.D.3d 1, 6 (1st Dep't 2009) (citing 22A N.Y. Jur. 2d, Contracts § 375)). However, "the doctrine of frustration of purpose . . . is not available where the event which prevented performance was foreseeable and provision could have been made for its occurrence." *Id.* (citing *Matter of Rebell v. Trask*, 220 A.D.2d 594, 598 (2d Dep't 1995)). The fact that an event may cause a party to realize lower profits or sustain a loss is insufficient to justify application of the doctrine of frustration. *Rockland Dev. Assoc. v. Richlou Auto Body, Inc.*, 173 A.D.2d 690, 691 (2d Dep't 1991).

The foreseeability of sanctions has prevented sanctioned entities from being excused from lease payments on properties they were no longer able to use. In one case, *Sage Realty v. Jugobanka*, sanctions had blocked all Yugoslavian entities from using or accessing their assets in the United States. The U.S. Treasury Department's Office of Foreign Assets Control (OFAC) blocked Jugobanka's assets, vacated and sealed the bank's New York premises, and then made rental payments on the premises from the bank's blocked assets. The court determined that sanctions were "reasonably foreseeable," and thus the defendant was not excused from performance based on affidavits and exhibits showing that parties were aware of deteriorating relations between Yugoslavia and the United States and of the potential for sanctions to be imposed. *Sage Realty Corp. v. Jugobanka*, 1998 WL 702272 (S.D.N.Y. Oct. 8, 1998); *Sage Realty Corp. v. Jugobanka, D.D.*, 1997 WL 370786 (S.D.N.Y. July 2, 1997). *See also Hungarian People's Republic v. Cecil Associates*, 127 F.Supp. 361, 363 (1955) (holding that the Hungarian government was not entitled to the doctrine of frustration to excuse performance on a lease after it was directed by the U.S. Government to close its consulates, because strained diplomatic relations between the United States and Communist countries were known and limits on diplomatic representation in the United States "conceivably could have been anticipated and guarded against" at the time of the lease).

II. ENGLAND

Under English law, a contract may be unenforceable where it contravenes a statutory prohibition ("statutory illegality") or where it is otherwise illegal or against public policy ("common law illegality"). Cases where a contract is valid when formed but performance subsequently becomes illegal or impossible are viewed under the doctrine of frustration of contract.

A. Statutory and Common Law Illegality

There are two distinct doctrines under which performance of a contract can be denied under English law on grounds of illegality. "Statutory illegality" arises where a law or regulation, expressly or impliedly, either prohibits the making of a contract completely or provides that a contract or certain of its terms are unenforceable. Because the unenforceability is simply the result of the application of a statute, the knowledge or culpability of the parties is irrelevant in

that context. “Common law illegality,” on the other hand, results where the formation, purpose or performance of the contract is illegal or contrary to public policy and where denial of enforcement is an appropriate response to that conduct. *Okedina v Chikale* [2019] ICR 1635. Judging whether performance should be denied on grounds of common law illegality requires an assessment of what the public interest requires having regard to a range of factors, including (a) the underlying purpose of the prohibition that has been transgressed, (b) public policies that would be impaired by denying the claim, and (c) whether denying the claim is a proportionate response. *Patel v Mirza* [2016] UKSC 42.

In international settings, English courts will not enforce an English law contract where performance of that contract is forbidden by the law of the place of performance, even if it would be permitted under English law. *Ralli Bros v Compania Naviera Sota y Azmar* [1920] EWHC 887 (Comm) at [297] (English law freight contract not enforced where the contract called for delivery of goods in Spain and freight charges exceeded legal limits in Spain). However, laws of jurisdictions other than the place of performance may also have an effect. In one case, an English borrower was held to be justified in refusing to make scheduled interest payments under an English law loan facility to a Russian-owned bank based in Cyprus that had been blocked under U.S. secondary sanctions. The English borrower would have been exposed to penalties under the U.S. sanctions rules if it made payments to its blocked Cyprus lender, and that was sufficient to excuse performance when the loan facility provided that the borrower would not be in default if amounts were not paid “in order to comply with any mandatory provision of law[.]” *Lamesa Investments Ltd v Cynergy Bank Ltd [2020]* EWCA Civ 821.

B. Frustration of Contract

Under English law, cases where performance becomes impossible or illegal as a result of a supervening governmental action are reviewed under principles of frustration of contract. Frustration occurs when, without fault of either party, a contractual obligation has become incapable of being performed because changed circumstances would render performance radically different from what was undertaken. *Davis Contractors Ltd v Farham Urban District Council* [1956] AC 696, 729. Frustration turns on whether performance in accordance with the literal terms of the contract differs so significantly from what the parties reasonably contemplated at the time of execution that it would be unjust to insist on compliance. *National Carriers v Panalpina* [1981] AC 675, 707. Factors to be considered include the terms of the contract, its context, the parties’ expectations and assumptions when the contract was formed, the nature of the supervening event and the parties’ reasonable and objectively ascertainable calculations as to the possibilities of future performance. *Edwinton Commercial Corporation v Tsavliris Russ (Worldwide Storage) Ltd (The Sea Angel)* [2007] 1 CLC 876.

It is difficult to succeed with a frustration claim in the English courts. For example, a recent case found that frustration does not apply where performance of a contract remains legal but its usefulness to a party is frustrated by reason of intervening governmental action, especially where the relevant risk was assumed by the aggrieved party under the contract. *Salam Air SAOC v Latam Airlines Groups SA* [2020] EWHC 2414 (English law aircraft leases not frustrated by Covid-related restrictions on air passenger flights in lessee’s home country, especially where the contract language allocated commercial risks to the lessee).

A number of sanctions-related English cases have involved international banking. In one early case, an English bank operating through its branch in Jerusalem found itself unable to make payments to its account customer based in Arab-controlled territory following the cessation of

the British mandate and the formation of the State of Israel in 1948. War had broken out, and under applicable Israeli law, payments to persons in enemy territory were prohibited. Israeli regulations allowed for payments to be made instead to a custodian, and payment was made in that fashion. When the plaintiff sued, the court held that the account agreement, which was governed by English law, was not frustrated, and that the plaintiff bank should instead look to recover its funds from the custodian on terms to be set in Israeli legislation. *Arab Bank Ltd v Barclays Bank* [1954] 2 W.L.R. 1022.

Another banking case arose out of the U.S. sanctions against Libya in 1986, which froze all Libyan property in the United States or in the possession or control of U.S. persons, including overseas branches of U.S. banks. The defendant U.S. bank, acting through London and New York branches, contended that it was impossible to make payments to its Libyan customer without committing an illegal act in the United States. The court held that the account agreements were not frustrated and the parties were not discharged, but rather the payment obligation was merely suspended. *Arab Foreign Bank v Bankers Trust Co* [1989] 2 All ER 252.

English courts will not find frustration of contract where applicable sanctions allow affected parties to apply for derogations and no attempt to apply for a derogation has been made. *Melli Bank plc v Holbud Ltd* [2013] EWHC 1506 (Comm). And, as in the United States, English law is not favorable to sanctioned entities who claim that supervening sanctions render repayment of preexisting debts illegal or discharged. *DVB Bank SE and others v Shere Shipping Company Ltd and others* [2013] EWHC 2321 (Comm) ("If one stands back and considers the broad effect of the argument of the Borrowers and the Guarantors, it amounts to a contention that large sums of money which were advanced before the Regulations were made do not have to be repaid. In my view this is not the effect of the Regulations nor is it consonant with their broad intent.")

III. GERMANY

Under German law, an obligor may be relieved of a duty of (specific) performance where performance would be illegal, impossible or impracticable.[1] In addition, if an intervening sanction fundamentally changes the circumstances that formed the basis for the parties' agreement, then the contract's terms may be modified to adapt them to the new circumstances.

A. Performance Becomes Illegal, Impossible or Impracticable

Under the §134 of the German Civil Code (*Bürgerliches Gesetzbuch*, or "BGB"), a contract that when entered into contravenes a legal prohibition is void (*nichtig*). In a manner somewhat

[1] A technical but important point is worth noting. Under U.S. and English common law, the principal remedy for breach of contract is damages, and the doctrines of illegality, impossibility, impracticability and frustration of purpose under U.S. and English law address whether performance is *excused* in certain circumstances, i.e., whether an obligor can fail to perform without being liable for damages for breach of contract. German law is different in that the primary remedy for breach of contract is specific performance, with damages being available if specific performance cannot be obtained and the obligor can be held responsible, usually on the basis of a negligent breach of duty of care and with the obligor's responsibility being rebuttably presumed. Accordingly, cases involving illegality, impossibility

reflective of the policy considerations inherent in the concept of illegality in common law, German law distinguishes between laws that prohibit a certain conduct (*Verbotsgesetze*) and other, often administrative laws (*Ordnungsvorschriften*) that may render conduct unlawful but are primarily directed at other purposes. While the distinction turns on the purpose of the law in question, sanctions are likely to be viewed as prohibitive laws in most cases.

On the other hand, if a performance was permitted at the time of contract formation but subsequently becomes unlawful, the contract will not be voided, but instead a party may be able to refuse performance under principles of impossibility or impracticability. The relevant provisions are set out in §275 BGB:[2]

> *§275 Exclusion of the Duty of Performance*
>
> *(1) A claim for performance is excluded to the extent that performance is impossible for the obligor or for any other person.*
>
> *(2) The obligor may refuse performance to the extent that performance requires expense and effort which, taking into account the subject matter of the obligation and the requirements of good faith, is grossly disproportionate to the interest in performance of the obligee. When it is determined what efforts may be reasonably required of the obligor, it must also be taken into account whether he is responsible for the obstacle to performance.*
>
> *(3) In addition, the obligor may refuse performance if he is to render the performance in person and, when the obstacle to performance of the obligor is weighed against the interest of the obligee in the performance, performance cannot be reasonably required of the obligor.*

A determination of impossibility (Para. 1) will be narrowly focused on whether performance is in fact possible. A determination of impracticability in general (Para. 2) or with respect to personal services contracts (Para. 3), on the other hand, requires a broad review of relevant circumstances under principles of reasonableness and good faith. The bar for a finding of impracticability is high, with performance being excused only in extraordinary cases where the cost of performance is so high in relation to the other party's interest that enforcement would appear abusive. Where performance is refused, the other party may terminate the contract, and the non-performing party may be liable for damages if it is found to be responsible for the relevant circumstances. Similar considerations affect whether illegality or other changed

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and impracticability under German law involve an analysis of whether (i) an obligor is relieved of its duty of (specific) performance, and (ii) somewhat separately, whether the obligor may nonetheless be held responsible for damages.

[2] Translations of BGB provisions in this alert are taken from the English translation made available by the German Federal Ministry of Justice here.

circumstances may be invoked as grounds for terminating a long term contract for cause (*aus wichtigem Grund*) pursuant to §314 BGB.

The application of these principles is fairly straightforward in cases where performance has become unlawful under German or EU sanctions or other laws. Performance obligations that would violate outright prohibitions are deemed legally impossible under §275(1) BGB, with the result that performance cannot be required.

The analysis is more complex with regard to conduct that has become unlawful under foreign (*i.e.*, non-German and non-EU) laws. German law distinguishes between "overriding mandatory provisions" within the meaning of Article 9 of the EU's Rome I Regulation[3] and other foreign laws. Overriding mandatory provisions are rules that a (foreign) country regards as "crucial for safeguarding its public interests, such as its political, social or economic organization[.]" Rome I, Article 9(1). Another country's overriding mandatory provisions *may* be given effect in so far as they apply in the place of performance and render performance unlawful, with regard to be had "to their nature and purpose and to the consequences of their application or non-application." Rome I, Article 9(3). In practice, foreign laws often will be taken into account when they directly affect a party's ability to perform, and the distinction between legal or practical impossibility on the one hand and impracticability on the other is not always clearly drawn.

The case law demonstrates the kinds of cross-border fact patterns that can arise. In an early case, the defendant, resident in a Soviet occupied zone (East Germany), was prevented by the zone's currency regulations from making payments to a creditor in West Germany. The German Highest Civil Court (*Bundesgerichtshof*, or "BGH") held that although the Soviet occupied zone's regulations did not apply in West Germany, they nonetheless rendered payment by the defendant practically impossible. The court noted that "the concept of impossibility … must be applied flexibly, taking into account the special circumstances of the individual case." BGH Ia ZR 273/63 (28 January 1965).

Similar to the courts in the United States and England, German courts do not readily excuse performance on grounds of claimed impossibility or impracticability. In a 1983 case, a German vendor had promised to deliver shirts to a German purchaser. The shirts had been manufactured in Korea and shipped to Hamburg, but the import of the shirts into Germany required an import license that could not be obtained. While noting in passing that smuggling the goods into the country would not reasonably be considered a viable option, the BGH sidestepped potentially complicated questions of impossibility and impracticability by holding that only the delivery of the goods in Germany, and not their importation, was the object of the contract, and performance was thus not excused. BGH VIII ZR 77/82 (8 June 1983).

More recently, the Frankfurt District Court allowed a Kuwaiti airline to decline boarding to an Israeli passenger on a flight from Germany to Thailand in light of a Kuwaiti boycott law that prohibited, with severe penalties, the transport of Israeli passengers. While the Kuwaiti law had no application in Germany, the fact that the flight in question included a stop in Kuwait (the passenger had been offered but declined direct flights on other airlines) and that the airline

[3] Regulation (EC) No. 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I).

would be subject to penalties under the laws of its home state was sufficient to excuse performance. Because it was based on nationality and not on religion, ethnic background, sexual orientation or other protected categories, giving effect to the embargo was held not to be incompatible with German public policy (*see* Article 21 of Rome I) or similar principles. LG Frankfurt am Main, 2-24 O 37/17 (16 November 2017).

Parties can be subject to conflicting obligations, especially where sanctions have extraterritorial effect. A 2011 case considered an attempted bank transfer on behalf of two German customers. The plaintiff bank, which had become subject to both U.S. and EU Iran-related sanctions, sent funds to the defendant, a U.S. bank operating in Germany. The defendant bank routed the payment through its London affiliate, where the funds were blocked. The applicable EU sanctions called for release of the funds to the German Bundesbank for further disposition, but that was not permitted under the U.S. sanctions rules without OFAC approval, which was not obtained. The Frankfurt Higher District Court ordered the funds to be released to the Bundesbank, reasoning that U.S. authorities were unlikely to impose penalties under the circumstances. OLG Frankfurt am Main, 23 U 30/10 (9 May 2011).

Yet further complexity is added in cases arising under blocking statutes, as illustrated by a recent (and still ongoing) case involving Deutsche Telekom and the German subsidiary of Iranian Bank Melli. Deutsche Telekom was providing telecommunications services to Bank Melli's German subsidiary under a long term services agreement when the United States withdrew from the Joint Comprehensive Plan of Action (JCPOA) in 2018 and reinstated its Iran sanctions, with Bank Melli being on OFAC's SDN list.[4] The EU reacted by adding the reinstated U.S. sanctions to the list of measures blocked by EU Regulation 2271/96, which, among other things, prohibits EU persons from complying with specified foreign sanctions.[5] Finding itself subject to conflicting obligations and potential penalties in both the United States and Germany, Deutsche Telekom first gave notice of termination of its contract with Bank Melli for cause, on the grounds that Bank Melli was excluded from SWIFT and could no longer pay, but the Hamburg Higher District Court held that Deutsche Telekom was required to accept payment in cash. OLG Hamburg 11 U 257/18 (6 June 2019). Deutsche Telekom then also gave notice of ordinary course termination (*i.e.*, without cause) to the next available termination date. When Bank Melli challenged that second termination as well, arguing that it was unlawful because it was in fact motivated by an effort to comply with sanctions blocked by Regulation 2271/96, the Hamburg Higher District Court sought a preliminary ruling from the European Court of Justice (ECJ). The ECJ held that Article 5 of the Regulation does not generally prohibit ordinary course terminations, but that where the available evidence indicates that the termination was issued to comply with a blocked sanction, the terminating party should establish that the termination was

[4] Specially Designated Nationals And Blocked Persons List (SDN) list, *see* here. U.S. persons are generally prohibited from dealing with SDNs absent OFAC licensing.

[5] Council Regulation (EC) No 2271/96 of 22 November 1996 protecting against the effects of the extra-territorial application of legislation adopted by a third country, and actions based thereon or resulting therefrom. Regulation 2271/96 was originally adopted in 1996 in an effort to block the extraterritorial effect of certain U.S. sanctions against Cuba, Iran and Libya. It is directed against sanctions measures listed in an annex to the Regulation, and the European Commission added the reinstated Iran sanctions to the relevant annex shortly after the United States' withdrawal from the JCPOA. Commission Delegated Regulation (EU) 2018/1100 of 6 June 2018 amending the Annex to Council Regulation (EC) No 2271/96.

not so intended. The ECJ further held that a termination found to have been issued in contravention of Article 5 may be annulled, provided that the annulment does not have disproportionate effects on the terminating party, weighing the objectives of the Regulation against the likelihood and extent of the economic losses to which the party may be exposed as a result of its inability to terminate. ECJ Case C-124/20 (21 December 2021). The case is now again before the Hamburg Higher District Court for a decision on the merits.

B. Modification Upon Change of Circumstances Forming the Basis of the Contract

In addition to the potential refusal of performance in cases of impossibility or impracticability under §275 BGB, a party may seek modification of a contract's terms pursuant to §313 BGB where the circumstances forming the basis of the contract have changed significantly. Where §313 applies, a contract's terms may be adapted to the changed circumstances, but the contract will not be voided and performance will not be excused. The provision reads as follows:

> *§313 Interference with the Basis of the Transaction*
>
> *(1) If the circumstances which became the basis of a contract have significantly changed since the contract was entered into and if the parties would not have entered into the contract or would have entered into it with different contents if they had foreseen this change, adaptation of the contract may be demanded to the extent that, taking into account all of the circumstances of the specific case, in particular the contractual or statutory distribution of risk, one of the parties cannot reasonably be expected to uphold the contract without alteration.*
>
> *(2) It is equivalent to a change of circumstances if material conceptions that have become the basis of the contract are found to be incorrect.*
>
> *(3) If adaptation of the contract is not possible or one party cannot reasonably be expected to accept it, the disadvantaged party may revoke the contract. In the case of continuing obligations, the right to terminate takes the place of the right to revoke.*

The provision is based on doctrines akin to common law concepts of frustration of contract and on German case law from the hyperinflationary environment of the 1920s. It is rarely invoked successfully, and its application is highly dependent on the circumstances of the individual case.

A change in law may be grounds for contract modification in some circumstances. A well-known 1984 case concerned a contract for the delivery of beer to Iran. The contract provided for deliveries to Iran at a discounted price and had been entered into in partial settlement of a damages claim for earlier defective deliveries. When imports of alcohol into Iran became illegal (and punishable by death) after the Iranian revolution in 1979, the court did not excuse performance under §275 BGB, but rather ruled in favor of an adjustment to the contract pursuant to §313 BGB and partially restored the Iranian importer's prior damages claim. BGH VIII ZR 254/82 (8 February 1984).

In another Iran-related case, a German insurer sought to delay payment of an insurance claim to a German policyholder. The claim related to deliveries from Iran, and the insurer pleaded that because it had been acquired by a U.S. group, it was now effectively subject to U.S. sanctions

legislation targeting Iran and could not pay on the claim until OFAC approval had been obtained. The Hamburg District Court held that the policy's sanctions clause concerned only German and EU sanctions, that the U.S./Iran embargo law did not apply in Germany and thus did not render performance illegal, and that contract modification under §313 BGB was not available because the change in circumstances was attributable solely to the insurer. LG Hamburg 401 HKO 7/14 (3 December 2014).

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