Client Alert - Russian Sanctions: The Impact on the Ability to Conduct Business

Article By

Business Law at Norris McLaughlin
Norris McLaughlin P.A.
Business Law Blog

Related Practices & Jurisdictions

- Corporate & Business Organizations
- Antitrust & Trade Regulation
- Financial Institutions & Banking
- Global
- Russia
- Ukraine
- United Kingdom
- European Union
- Japan

Friday, March 4, 2022

The Sanctions
The sanctions imposed by the United States, the United Kingdom, the European Union, Japan, and others on Russia in response to the horrific invasion of Ukraine already have made profound impacts and prompted questions regarding these impacts.

These sanctions include financial restrictions imposed by the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) prohibiting United States persons from engaging in transactions with the Central Bank of the Russian Federation, the National Wealth Fund of the Russian Federation, and the Ministry of Finance of the Russian Federation thereby effectively immobilizing any assets of the Central Bank of the Russian Federation held in the United States or by U.S. persons, wherever located.

Sanctions have also been imposed regarding exports to Russia. Notably, the U.S. Department of Commerce, Bureau of Industry and Security (BIS) has issued a final rule, “Implementation of Sanctions Against Russia Under the Export Administration Regulations (EAR).” This final rule adds new license requirements for all Export Control Classification Numbers (ECCNs) in Categories 3-9 of the Commerce Control List (CCL). These items include microelectronics, telecommunications items, sensors, navigation equipment, avionics, marine equipment, and aircraft components. Under the stringent licensing review policy that is being implemented, applications for the export, reexport, or transfer (in-country) of items that require a license for Russia will be reviewed, with certain limited exceptions, e.g., humanitarian needs, government space cooperation. The BIS has also implemented a foreign direct product rule (the Russia FDP Rule), which establishes a control over foreign-produced items that are (i) the direct product of certain U.S. software or technology subject to the EAR; or (ii) produced by certain plants or major components thereof that are the direct product of certain U.S. software or technology subject to the EAR. This control applies when the foreign-produced item is destined to Russia or will be incorporated into or used in the production or development of any part, component, or equipment produced in or destined to Russia. BIS’s restrictions are aimed to impact significantly Russia’s ability to acquire items it cannot produce itself.

Conduct of Business

While international companies have had a presence in Russia for many years, in today's global marketplace, smaller companies also conduct business either directly or indirectly in Russia. Accordingly, the Russian sanctions pose immediate concerns for these companies.

First, companies that manufacture products or supplies that are sent to Russia either directly or through another entity will need to analyze whether they can continue to export legally their products and supplies to Russia in view of the rules imposed by the BIS. In particular, companies must determine (i) whether certain licenses will be required, (ii) the actions necessary to procure these licenses, and (iii) the timing and likelihood of procurement. Significantly, companies must determine whether their products and supplies that they provide for an entity not in Russia will be exported by that entity to Russia. In other words, companies may not be able to do, even indirectly, what they cannot do directly.
Second, if the sanctions preclude a company from exporting its products and supplies to Russia, the company will need to review its supply contacts to prepare itself for possible claims for non-performance. In conducting this review, companies should be aware of and analyze possible defenses they may have to such claims. Further, these companies must be aware of the possibility that their suppliers will invoke the same defenses if the companies bring claims against these suppliers.

**Force Majeure**

Contracts often include *force majeure* provisions, which set forth reasons excuse a party's performance under a contract as a result of specified events. These events typically include wars, invasions, insurrections, riots, acts of God, other causes beyond the control of a party and orders, and possibly regulations or restrictions imposed by governmental authorities. Accordingly, a company affected by the Russian sanctions must ascertain whether its supply contracts contain *force majeure* provisions and whether the Russian sanctions constitute an event that excuses full or delayed performance under the contract. The provisions may also provide that performance is excused only for the length of time the *force majeure* event exists, or that a party must engage in efforts to mitigate the effects of the *force majeure* event. This analysis may require, for example, determining whether the Russian invasion, which is an undeclared war on Ukraine, can excuse performance, or whether the sanctions fall within the scope of other provisions of the *force majeure* provisions, thereby excusing performance or delayed performance.

**Restatement (Second) of Contracts**

Even if a determination is made that *force majeure* is not a viable defense, several sections of the Restatement (Second) of Contracts, including Sections 261, 264, and 265, should also be reviewed and analyzed for possible applicability.

- **Section 261** covers discharges by a supervening impracticability. This section provides that when, after a contract is made, a party's performance is made impracticable without its fault by the occurrence of an event, and the non-occurrence of this event was a basic assumption on which the contract was made, the party's duty to render that performance is discharged unless the language or the circumstances indicate the contrary.

- **Section 264** covers the prevention of performance by governmental regulation or order. This section provides that if a party's performance of a duty is made impracticable by having to comply with a domestic or foreign governmental regulation or order, and the non-occurrence of the regulation or order was a basic assumption on which the contract was made, its duty to render that performance is discharged unless the language or the circumstances indicate the contrary.

- **Section 265** covers the discharge of performance by supervening frustration. This section provides that where, after a contract is made, a party's principal purpose is substantially frustrated without the party's fault by the occurrence of an event, and the non-occurrence of this event was a basic assumption on
which the contract was made, the remaining duties to render performance are discharged unless the language or the circumstances indicate the contrary.

**Impracticability and Frustration of Purpose**

In analyzing the applicability of the defense of impracticability of performance, the focus of the inquiry is whether the non-occurrence of the circumstance was a basic assumption on which the contract was made. If a party’s performance under the contract remains practicable, but to perform it is beyond the party’s capacity, the party is not ordinarily discharged from its obligations under the contract. If the impediment to performance is a government regulation or order, the regulation or order must make it impracticable for the party to comply with the regulation or order and to perform under the contract.

To establish a defense of frustration of purpose, the purpose that is frustrated must have been the principal purpose for which the party made the contract, such that without this purpose, entering into the contract would make little sense. In addition, the frustration must be substantial, and the non-occurrence of the event must have been a basic assumption on which the contract was made.

With respect to the defenses of both impracticability and frustration of purpose, a party has an obligation to make reasonable efforts to overcome the impediment to performance. In addition, if impracticability of performance or frustration of purpose is only temporary, the duty to perform may be suspended only temporarily, and when the impracticability or frustration ceases to exist, the party may then again be required to perform under the contract.

The foregoing clearly raises questions concerning whether the Russian sanctions make performance under a contract impracticable or has frustrated the primary purpose of the contract. Answering these questions can be daunting given that the extreme nature of the Russian sanctions and their impact on the ability of companies to manufacture products for export to Russia may be unparalleled in recent history.

©2022 Norris McLaughlin P.A., All Rights Reserved

National Law Review, Volume XII, Number 63