

List of questions from EFET members relating to Russia sanctions

This analysis has been jointly prepared by Reed Smith LLP (in relation to matters relating to U.S. sanctions law and English law) and DLA Piper (in relation to matters relating to German law).

This analysis has been conducted at a high level and is not exhaustive or definitive in respect of all the potential issues. This Memorandum should not therefore be relied upon as being legal advice. In all cases, the precise impact of sanctions on any EFET document or transaction would always depend on its facts and so the parties to any EFET document or transaction should seek specific advice.

The responses set out herein are correct as of the date specified with respect to that response, unless stated otherwise, and neither Reed Smith LLP nor DLA Piper is responsible for monitoring or updating the responses.

Payment obligations:

1. **There is a query about US OFAC Directive 3 relating to debt limitations of 14 days when dealing with Russian sanctioned entities. Members are trying to get clarity as to whether OFAC would consider pre-sanctions contracts with payment terms >14 days to be grandfathered (as they do for loans/revolving credit facilities), and if so what types of factual elements would need to be specified in the pre-sanctions contracts to satisfy OFAC for this purpose.**

Response Date: 12.04.2022

- 1.1 Directive 3 under EO 14024 restricts the granting or issuance of new debt or new equity to listed entities on or after 26 March 2022. The key issue to identify is not when the contracts were entered into, but rather when the new debt is deemed to have been granted – which in the context of sales of power and gas under the EFET General Agreements, is when title or ownership to the underlying power or gas transferred to the buyer¹.
- 1.2 For example, if a contract involving a sale of gas to a listed entity was entered into on 1 March 2022 (i.e. after Directive 3 EO 14024 came into force), but title to the underlying gas passed to the listed entity on 2 March 2022, then Directive 3 EO 14024 will not apply to such a contract, as the “debt” would have been granted before 26 March 2022.
- 1.3 However, if a similar contract was entered into on 23 February 2022 (i.e. before Directive 3 EO 14024 came into force), but title to the underlying gas passed to the listed entity on 27 March 2022, then this would constitute “new debt” and therefore payment for the underlying gas must be cleared within 14 days of title having transferred.
- 1.4 For completeness, even if the new debt is deemed to have been issued or granted before 26 March 2022 thereby falling out of the scope of Directive 3 EO 14024, such contracts must also still comply with any other applicable restrictions relating to such listed entity. Some entities

¹ See OFAC FAQ 419.

are listed under various Directives which have different rules on the maturity threshold and what is considered “new debt”².

2. **Are pre-existing EFET transactions (executed prior to March 26 but with deliveries post March 26) not covered by these new sectoral sanctions? Is this an accurate representation of the rules?**

Response Date: 12.04.2022

2.1 This is not an accurate representation of the rules. We repeat our conclusions at paragraphs 1.1 to 1.4 above.

3. **Are counterparties affected by the US sectoral sanctions regime able to comply with the 14-day payment requirement in the EFET agreement in all circumstances? If not, what adjustments can be made to allow parties to comply? In particular, how should this part of the US sanctions be interpreted in relation to the current EFET payment terms of “20th day of the month following delivery” – would that constitute new debt? Is prepayment permitted?**

Response Date: 12.04.2022

3.1 §6(3) and 14(3) of the EFET General Agreement indicates that “the transfer of risk and title” occurs at “the Delivery Point” (i.e. upon delivery). If title transfers to an entity subject to the restrictions under Directive 3 EO 14024 on or after 26 March 2022, then this would constitute “new debt”. If no amends are made to the payment terms under the standard EFET General Agreement which provide for payment on the 20th day of the calendar month following delivery, then such payment terms would not comply with the 14 day payment requirements. A U.S. Person should refrain from entering into any transaction or contractual agreement in which they know or have reason to know that payments might not be received within the relevant payment period.

3.2 Accordingly, U.S. Persons dealing with a company listed in Annex 1 to Directive 3 EO 14024 would have to require payment within 14 days of delivery (including by way of prepayment). This should be contractually provided for (e.g. on an Individual Contract basis or as a general amendment to the relevant EFET General Agreement).

4. **Members are also wondering if the standard EFET payment terms being perhaps modified or renegotiated in light of sanctions against Russia – either to pre-empt any sanction which might at some point bite on a particular relationship governed by an EFET general agreement, or simply to reduce credit risk in the uncertain environment.**

Response Date: 12.04.2022

4.1 We are not aware of any current plans to amend the standard EFET payment terms in either EFET General Agreement, although we note the recent EFET Report on Electronic Settlement Matching (eSM) and accelerated settlement of OTC energy contracts.

4.2 As long as relevant counterparties are not listed on a sanctions list, contractual amendments should generally be possible. Once a counterparty is listed on a sanctions list, it would need to

² Ibid.

be taken into account that the granting of an economic benefit would be forbidden under the sanction regimes.

5. **Contract settlement in roubles: please evaluate the potential requirement of the Russian government that payment for Russian gas is made in roubles and its impact on the operation of the EFET General Agreement.**

Response Date: 12.04.2022

Position under German law

- 5.1 § 13 (2) of the EFET General Agreement provides that payments shall, unless otherwise agreed, be made in Euro (by wire transfer to the payment address or bank account provided by the other Party as specified in the Election Sheet). The requirement of the Russian government that payment for Russian gas is to be made in roubles should therefore not be in line with relevant contractual agreements (unless so agreed). Accordingly, where payments should be made in Euro, Russian suppliers could therefore in our view not invoke any contractual rights that would typically be triggered in case non-performance/payment default.
- 5.2 However, the Russian ‘Decree on a special procedure for the fulfillment by foreign buyers of obligations to Russian suppliers of natural gas’ (**Decree**) i.a. specifies that further supply of natural gas by a Russian supplier to certain foreign buyers (as further specified in the decree) is prohibited, if the payment deadline for the gas supplied under relevant contract has come, payment by a foreign buyer is not made or is made in foreign currency, and (or) not in full, and (or) to an account in a bank that is not an authorized bank in accordance with the Decree, and such delivery is carried out to foreign states that commit in relation to the Russian Federation, Russian legal entities and individuals, unfriendly actions.
- 5.3 In light of such prohibition it may be expected that Russian suppliers claim release from delivery obligations due to an impossibility to perform under the Force Majeure provisions under the EFET General Agreement. It is however questionable whether such potential claims would indeed be successful in case of a dispute under German law (given that it is unclear in this respect whether a foreign sanctions regime would be taken into account at all by German courts/arbitrators).

Position under English law

- 5.4 We repeat German counsel’s conclusions at paragraphs 5.1 to 5.3 above, and set out an explanation of consider the meaning of “impossibility” in the context of the Force Majeure provisions under the EFET General Agreement below.
- 5.5 To rely on the Force Majeure provision, the Claiming Party has to establish that the Force Majeure event to which it is subject: (i) is beyond its reasonable control; (ii) that the occurrence could not reasonably have been avoided or overcome by the Claiming Party; and (iii) that it makes it impossible for the Claiming Party to perform its delivery or acceptance obligations. Note that the force majeure provision does not extend to impossibility to perform payment obligations.

- 5.6 There is no clear authority under English law on the meaning of “impossible” in this context. Where a party seeks to invoke the protection of a Force Majeure provision that uses the test of “prevented”, it must show that performance has become physically or legally impossible (and not merely difficult or unprofitable).
- 5.7 Under English law, the generally understood position is that the legal impossibility or illegality must arise under the law governing the contract or the law of the place where performance of the relevant obligations under the contract is required to take place. For the purposes of § 7 of the EFET Gas and EFET Power, the place of performance will be the place where either delivery or acceptance was to take place. It is unclear whether illegality under another law affecting a Party (for example, a Russian government decree that affects Russian suppliers) will be recognised under English law.
- 5.8 In order to establish physical impossibility under English law, it is necessary to show that the method of performance stipulated in the contract has become impossible.
- 5.9 To perform an obligation that would be in breach of English law (e.g. prohibited in respect of an entity subject to asset freeze restrictions under UK sanctions laws) is likely to be a legal impossibility.

6. **Payments are being systematically withheld by the Banks, mostly due to compliance backlogs for more than 10 days (after the payment due date). This puts the Parties in payment defaults. What are the legal instruments that the Parties can use at this moment under the EFET Agreements?**

Response Date: 12.04.2022

- 6.1 For the buyers being in payment default, there are no specific contractual instruments under the EFET General Agreement in order to address such default respectively to mitigate its consequences. Instead, from a practical perspective, buyers should in our view liaise with their banks in order to ensure due payment.
- 6.2 For the sellers, in case of payment default of their counterparty, a termination right for Material Reason according to §10.5(a)(i) of the EFET General Agreement may apply.

Termination right and set-off:

7. **If a market party decides to terminate its framework agreements with CPs on the sanctions list – which options are available to it under the EFET agreement? Can we follow the “ordinary termination” option that EFET offers, and if so, could it face any consequences with the payments that would follow?**

Response Date: 12.04.2022

- 7.1 The analysis below proceeds on the assumption that the EFET agreement does not incorporate the EFET trade restriction provisions. To the extent that it does, the market party should consider such provisions as the primary recourse. A further discussion on this provision is set out at paragraphs **Error! Reference source not found.** et seq below.

Position under German law

- 7.2 The ordinary termination option under the EFET Gas will probably not help to mitigate the concerns as § 10 (2) of the EFET General Agreements makes clear that in the event of ordinary termination, the General Agreement remains legally binding on the Parties until in respect of all rights and obligations already created or existing under the Agreement prior to the date of the ordinary termination are fully performed by both Parties.
- 7.3 The only option likely to be available in relation to a termination would be an early termination for Material Reason under § 10 (3) of the EFET General Agreements. In this respect, we would deem it rather unlikely that a termination as such (which would also release the sanctioned counterparty from contractual obligations) itself would be considered the granting of an economic benefit which would be forbidden under the applicable sanction regimes.
- 7.4 However, in each case, where the termination would result in the calculation of a Termination Amount and where this would result in the set-off of obligations between the Parties, from our perspective, this would not be permissible.

Position under English law

- 7.5 We repeat the remarks of German counsel with respect to ordinary termination and § 10 (2) of the EFET General Agreements.
- 7.6 Under § 10(1) of the EFET General Agreements (*Term and Termination Rights*), such Agreements may be terminated where a Material Reason (including failure to make a payment and non-performance of any other material obligation e.g. delivery obligations) has occurred and is continuing (at § 10(3)).
- 7.7 Where the rights accruing under the various provisions above result in payments being due to a counterparty on the sanctions list, in relation to asset freeze measures, subject to contrary wording under the relevant sanctions, there may be an exemption that expressly provides for payments due under contracts, agreements or obligations that were concluded or arose before a party became subject to asset freeze restrictions, to be made to a frozen account. The definition of “due” in this context is unclear, and we consider that caution should be exercised and further advice sought prior to attempting to make any payments under the exemptions provided by the derogation. Nonetheless, if such derogation is available, the Terminating Party may be able to rely on this to make payment to other Party, provided always that the payment is made into, a frozen account.
- 7.8 Conversely, where the calculation of any Termination Amounts results in sums being due and payable to the Terminating Party, it is possible under the relevant sanctions to apply to the relevant competent authority/authorities for the release of those funds to the extent they are subject to any asset freeze, for the purposes of enforcing and satisfying the Terminating Party’s claim.
- 7.9 It may be possible to construe an Early Termination in and of itself as providing an entity subject to asset freeze restrictions with an economic resource for the purposes of the relevant sanctions. Whilst this area of the law is entirely untested under English law, and it is therefore

not possible to come to a definitive view, to the extent any exercise of its termination rights would place the Terminating Party in breach of the relevant sanctions, the enforceability of those rights would be questionable.

8. **To what extent can we rely on a foreign sanction to suspend our obligations / exercise our right of termination of an EFET General Agreement?**

Response Date: 12.04.2022

Position under German law

8.1 Generally, foreign sanctions are not directly applicable to a party respectively not affecting its performance obligations should in our view not trigger any suspension rights or (autonomous) termination rights for such (non-affected) party. Obviously, where the counterparty should however cease performance of contractual obligations in light of foreign sanctions, relevant contractual remedies may apply.

Position under English law

8.2 If a counterparty becomes subject to a non-UK sanction that is not directly applicable to the other Party, we would not expect that in the absence of specific contractual provision providing otherwise, that occurrence would of itself trigger any suspension rights or (autonomous) termination rights being available to such Party.

8.3 Under English law, contractually agreed sanctions provisions are an established and accepted approach to mitigate sanctions risks. There have been a number of cases before the English courts which required a contractual analysis of the relevant sanctions provisions. The general principle is that the English courts will recognise and enforce contractually agreed sanctions provisions. The English courts would look at the wording and the substance of the sanctions provisions and would not re-characterise the provisions unless a court considers that the evidence shows that the wording of the sanctions provisions does not reflect the genuine intention and agreement of the Parties.

9. **Should there be direct sanctions imposed on Gazprom (Russian entity) or the Russian gas sector, what would happen practically to the contract, would it be automatically void? What would happen to the current position with GMT (UK entity)?**

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Position under German law

9.1 Even where an entity would be directly targeted by applicable sanctions (and this could also be the case in relation to a UK Gazprom entity, from our perspective contracts entered into before the implementation of the sanction regimes) would generally not be held void under German law. This would obviously be different in case of the conclusion of new contracts/transactions after the point of the implementation of the sanction regimes.

- 9.2 While there are voices in German legal literature that highlight that contracts for continuing obligations should be void in case of applicable sanctions, from our perspective – especially due to the fact that sanction regimes usually only apply for a limited time period – there are good arguments that other legal instruments (Force Majeure etc.) available under the contracts and statutory laws should be sufficient and not require the contracts and transactions entered into before the implementation of the sanction regimes to be held void.

Position under English law

- 9.3 In our view, should direct sanctions be imposed on Gazprom or the Russian gas sector, an existing contract with Gazprom or GMT (its UK subsidiary) will not be automatically void.
- 9.4 As a matter of English law, there is a distinction between contracts that are treated as void *ab initio* on grounds of public policy or illegality, that is to say void as a category so that no rights or liabilities that are recognized in law could have ever accrued under them, and those contracts that are said to be “discharged” by a supervening illegality. The latter category involves a subsequent change in either the law or the factual circumstances surrounding a particular contract which renders the performance of a particular obligation under that contract illegal, for example where the relevant sanctions are imposed after the contract has been entered into.
- 9.5 The law relating to contracts that are void as a matter of public policy (or what might be considered to be equivalent to mandatory public law) from their outset is uncertain as to what precisely will constitute a contract offensive to “public policy” for those purposes. What is clear is that a number of key rules³ have emerged under English law through the gradual development of case law⁴, and the English courts have the discretion to treat the contract as “null and void” for the purposes of preventing the enforcement of any rights arising out of the contract that might have accrued to either of the parties⁵.
- 9.6 In particular, where a contract at its formation can only be performed by the commissioning of a criminal offence under English law, or the performance of an obligation otherwise forbidden by English statute⁶, the courts have treated the contract as void for the purposes of enforcement.
- 9.7 Under the Sanctions and Anti-Money Laundering Act 2018 and the relevant UK sanctions thereunder, the breach of restrictions is a criminal offence under UK law. On that basis, whilst

³ See *Patel v Mirza* [2016] UKSC 42 at [101] which provided that when considering whether recovery for a claim tainted with illegality would be harmful to the integrity of the legal system, English courts must “(a) [consider] the underlying purpose of the prohibition that has been transgressed, (b) [consider] conversely other relevant public policies which may be rendered ineffective or less effective by denial of the claim, and (c) keeping in mind the possibility of overkill unless the law is applied with a due sense of proportionality”.

⁴ Ibid

⁵ See *Parkingeye Ltd v Somerfield Stores Ltd* [2012] EWCA Civ 1338 describing the illegality defence “as notoriously knotty territory”. See *Patel v Mirza* [2016] UKSC 42 which provided structured and clear principles surrounding the complexity arising from past cases, and also relevant remedies. See also *Henderson (A Protected Party, by her litigation friend, The Official Solicitor) v Dorset Healthcare University NHS Foundation Trust* [2020] UKSC 43 which analysis the scope and effect of *Patel v Mirza*.

⁶ See *Okedina v Chikale* [2019] EWCA Civ 1393, [2019] ICR 1635 at [12], which states that the “underlying principle is straightforward: if the legislation itself has provided that the contract is unenforceable in full and in the relevant respect, the court is bound to respect that provision. That being the rationale, the knowledge or culpability of the party who is prevented from recovering is irrelevant: it is a simple matter of obeying the statute”.

there is very little case law on the point that is directly applicable, it is possible that a contract entered into with a party that is already subject to asset freeze restrictions might be deemed a contract rendered illegal by statute and/or a contract for the purposes of commissioning a criminal offence, and accordingly treated as null and void where no licence is available or where the intention of the parties is to perform without the obtaining of any relevant licence⁷.

10. If a party / the counterparty is directly sanctioned would the operation of set-off be in breach of the sanction under English and/or German law?

Response Date: 12.04.2022

Position under German law

10.1 Yes. In the relationship with a directly sanctioned party the balancing of claims may not occur since this would release frozen funds/resources of the sanctioned party or make funds/resources available. Permits to release frozen funds may generally be granted by competent national authorities if such releases are used for payments to be made by the sanctioned party and funds are not made available to the sanctioned party or other parties caught by the sanctions regime.

Position under English law

10.1 Assuming a counterparty ("Party B") is subject to asset freeze measures under U.S., UK or Singapore sanctions laws, assuming that Party A is subject to compliance with the relevant sanctions laws, no set-off will be allowed as that would constitute making available funds or economic resources to Party B.

10.2 For further information on the application of the provisions under the EFET General Agreements, we refer to the conclusions in Reed Smith's legal memorandum issued on 7 April 2022.

FM clauses and delivery obligations in the EFET General Agreements:

11. In the event where for example Russian gas supplies would run be stopped (from one day to the next):

(i) [In the event that volumes are reduced/allocated pro rata – which rule apply and how are volumes allocated from a practical point of view]

Response Date: 12.04.2022

Position under German law

11.1 The regulatory framework for a natural gas shortage situation is on European level governed by the Regulation (EU) 2017/1936 (Security of Supply (SoS) Regulation) and in Germany by the

⁷ It is difficult to get further guidance from HM Treasury given the difficulties with the case law and the fact specific nature of this issue.

German Energy Act (EnWG), the German Energy Security Act (*Energiesicherheitsgesetz*) and the German Gas Security Ordinance (*Gassicherungsverordnung*).

- 11.2 Broadly summarized: Subject to the emergency level, gas supply company's and specifically gas network operators must make use of various market-based measures (such as usage of internal and external control energy, network circuits (*Netzschaltungen*) etc.) prior to reducing network capacities and or adjusting gas feed-in/withdrawal. In principle, the gas supply companies/gas network operators decide on their own responsibility, taking into account the respective risk situation and supply situation, which measures are specifically necessary and suitable to ensure the functioning of the market for as long as possible. However, they are with priority responsible for ensuring the supply of so-called protected customers (i.e. in simple terms household customers, social services and heat supply installations). Only where such market-based measures are not sufficient to sustain gas supply reliability, the German government may proclaim emergency level and issue disposals in the function as load balancer (*Lastverteiler*).
- 11.3 *For more detailed information, please refer to the Emergency Plan for Gas for the Federal Republic of Germany issued by the German government:*
[https://www.bmwi.de/Redaktion/EN/Downloads/E/emergency-plan-gas-germany.pdf? blob=publicationFile&v=4](https://www.bmwi.de/Redaktion/EN/Downloads/E/emergency-plan-gas-germany.pdf?blob=publicationFile&v=4)

Position under English law

- 11.4 On the Implementation Period Completion Day, Regulation (EU) 2017/1936 was incorporated into UK law by The Gas (Security Of Supply And Network Codes) (Amendment) (EU Exit) Regulations 2019 (the "**UK SoS Regulations**"). The UK SoS Regulations also amended provisions of four pieces of directly applicable EU tertiary legislation, namely: (i) Commission Regulation (EU) 2015/703, (ii) Commission Regulation 2017/460, (iii) Commission Regulation 312/2014, and (iv) Commission Regulation (EU) 2017/459 (together, the "**EU network codes**")
- 11.5 The summary of Regulation (EU) 2017/1936 under paragraph 11.2 above applies similarly in the UK, in relation to the 'onshored' version of Regulation (EU) 2017/1936 under UK law, however we note the following differences:
- 11.5.1 The UK SoS Regulations have removed, *inter alia*, the legal obligations for solidarity cooperation between the UK and EU Member States, and the duty to collaboratively assess the risks to EU security of gas supply and create plans to mitigate against these risks, because it is not possible to unilaterally provide for the reciprocal obligation that such duties rely on under UK law.
- 11.5.2 The UK SoS Regulations have also amended UK Transmission System Operators' ("**TSOs**") obligations to other TSOs the UK and EU, such that UK TSOs must cooperate with other UK TSOs, and must endeavour to cooperate with non-UK TSOs.
- 11.6 In addition to the retained EU law version of Regulation (EU) 2017/1936, the following domestic regulations are relevant to gas supply emergencies in the UK: Energy Act 1976, The Civil Contingencies Act 2004, Gas Safety (Installation and Use) Regulations 1998, Gas Safety (Management) Regulations 1996, Network Emergency Coordinator Safety Case, T/PM/E1 –

National Gas Supply Emergency Arrangements, T/PM/E2 – Local Gas Supply Emergency Arrangements, Uniform Network Code.

- 11.7 The UK Government's emergency plan in relation to gas supplies can be found in its National Emergency Plan for Downstream Gas and Electricity (last updated on 11 December 2014): <https://www.gov.uk/government/publications/national-emergency-plan-gas-and-electricity>

(ii) What is the consequence for contractual delivery obligations and how is that dealt with under the EFET?

Position under German law

- 11.8 Under German law, where:

- (i) the counterparty is actually unable to perform delivery obligations because of reduced supplies from pre-suppliers and where no alternative procurement option exists; or
- (ii) where there should be steering measures or governmental disposals re. the gas allocation/gas flows out of control of the respective market participants,

such situations should in our view generally be covered by the Force Majeure clause under the EFET General Agreements, having the consequence that the affected market participant will – subject to compliance with notification obligations and other applicable requirements - be released from the obligations to the extent he is prevented to perform.

- 11.9 Furthermore, where the Force Majeure clause applies, the counterparty will be released from its corresponding delivery/acceptance obligations. In case of a long-term force majeure event, termination rights may apply.

- 11.10 The above situations are to be differentiated from situations where delivery would generally still be available at a significantly increased price. Such situations should in our view likely not be covered by the contractual Force Majeure clause (and also not by statutory rules on impossibility to perform). Instead, it may however, subject to the individual case, potentially be possible to claim an adjustment of contract under the principle of frustration of contract as governed by section 313 of the German Civil Code (while the hurdles for such provision must be considered high).

Position under English law

- 11.11 German counsel's analysis under paragraphs 11.8 and 11.9 would apply equally in relation to an EFET Agreement governed by English law.

- 11.12 The position under English law is also similar in relation to situations where delivery is still possible, but at a significantly increased price. As noted in paragraph 5.6 above, a Party would not be able to invoke the protection of a Force Majeure provision that uses the test of "prevented", if performance has merely become difficult or unprofitable.

- 11.13 There is no statutory right for parties to claim an adjustment of contract under English law.

(iii) What is the threshold to call FM (if gas still can be sourced on the markets, probably no FM. But what if 50% is still available)?

Position under German law

11.14 Unfortunately, there is no clear answer to this. Ultimately, this would be subject to a detailed review in the individual case and would heavily depend on the scope of the market disruption, the options to buy and the prices for alternative volumes.

11.15 We note however that the Long Term Force Majeure termination right will only be triggered where in respect of an Individual Contract the obligations of the Claiming Party have been adversely affected by Force Majeure on each Day for a consecutive period of Days exceeding the Long Term Force Majeure Limit and by on average more than fifty (50) per cent of the contracted quantity during such period.

Position under English law

11.16 We repeat our comments under paragraphs 5.5 to 5.9 and 11.11 to 11.13 above. It is unlikely that this situation would be considered a Force Majeure Event.

(iv) What are the consequences of FM and what are foreseeable scenarios here?

Position under German law and English law

11.17 Please refer to the answer given to the second sub-question to this question 10 above.

12. When a sanction is directly applicable to a contract, is it necessary under English law/German law to meet all the conditions of force majeure to trigger it?

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Position under German law

12.1 Yes, in order to invoke any rights under the Force Majeure provision, relevant requirements must still be met.

Position under English law

12.2 To the extent that a Party is relying on Force Majeure to excuse itself from performing affected obligations, it must rely on all the conditions of Force Majeure to trigger it.

12.3 Where Parties have incorporated the relevant EFET Trade Restriction Clause, a Party must similarly meet all the conditions thereunder to trigger that clause.

12.4 For further information on the application of these provisions under the EFET General Agreements, we refer to Reed Smith's legal memorandum issued on 7 April 2022.

English law as governing law

13. To what extent will EU/US/Russian/non UK sanctions be applicable to EFET General Agreement governed by UK law? And under which conditions?

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13.1 EU, U.S., Russian or non-UK sanctions (e.g. Singapore sanctions) may be applicable to an English law governed EFET General Agreement if at least one of the parties to such agreement is a relevant person under those regulations, for example, the party is a “U.S. Person” or a “Singapore Person”.

U.S. Persons

13.2 U.S. sanctions can generally be divided into two categories: so-called “primary” sanctions and “secondary” sanctions.

13.3 Primary sanctions apply to U.S. persons or in situations where there is a U.S. nexus, such as involvement by a U.S. person, U.S.-originating goods, or a transaction taking place within the U.S.. A “U.S. person” is defined as any United States citizen, permanent resident, entity organized under the laws of the United States or any jurisdiction within the United States, or any person in the United States.

13.4 Secondary sanctions authorize the U.S. Department of the Treasury’s Office of Foreign Assets Control (“**OFAC**”) or the State Department to threaten sanctions on a person, including a non-U.S. person, for a specified activity. These sanctions are intended to discourage non-U.S. persons from engaging in certain transactions even if the transaction has no U.S. nexus (and is thus not subject to primary sanctions).

UK Persons

13.5 UK sanctions generally only apply to (i) “UK Persons”, irrespective of where they are operating globally; and (ii) acts in the UK or in the UK territorial sea by any person.

13.6 A “UK Person” is:

13.6.1 A British citizen, a British overseas territories citizen, a British National (Overseas) or a British Overseas citizen;

13.6.2 A person who under the British Nationality Act 1981 is a British subject;

13.6.3 A British protected person within the meaning of the British Nationality Act 1981;

13.6.4 An entity incorporated in the UK (i.e. includes Scotland and Northern Ireland);

13.6.5 If an order is made by the UK government to include an entity constituted under the law of the Channel Islands, Isle of Man, or any of the British overseas territories.

- 13.7 The UK Office of Financial Sanctions Implementation (“OFSI”) will only seek to enforce breaches of financial sanctions where there is a “UK nexus”. OFSI advises that this can be established by “a UK company working overseas, transactions using clearing services in the UK, actions by a local subsidiary of a UK company (depending on the governance), action taking place overseas but directed from within the UK, or financial products or insurance bought on UK markets but held or used overseas”.⁸

Singapore Persons

- 13.8 The Singapore Government’s financial measures apply to all financial institutions in Singapore, including banks, finance companies, insurers, capital markets intermediaries, securities exchanges, and payment service providers. Digital payment token service providers are therefore specifically prohibited from facilitating transactions that could aid the circumvention of the financial measures.
- 13.9 Singapore also imposes sanctions on other states, based on the UN Security Council Resolutions. These sanctions apply to all financial institutions in Singapore, non-financial institutions and natural persons in Singapore.
- 13.10 In addition, we refer to our response to question 8 above. EU/US/Russian/non-UK sanctions may be applicable to an English law governed EFET General Agreement if, for example, parties have incorporated those sanctions regimes in the definition of “Trade Restriction” in the EFET Trade Restriction Clause.

14. **Upon a disruptive event (e.g. bombing of a pipeline), that affect the ability of a party to deliver gas to its counterparty, I can foresee discussions on the foreseeability of the event (was it really not foreseeable, as it is war?) or on the ability to perform (gas could still be available on the markets at 100 times the contract price).**

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Position under German law

- 14.1 As regards the foreseeability of certain events, unfortunately, from a German law perspective, there will be no clear guidance on this point. We would expect that an act of war and specifically its precise effects for the gas supply would however generally be hard to be considered foreseeable. However, we agree that parties could well try to use this argument in relevant situations.

Position under English law

- 14.2 It is possible that certain obligations under an EFET General Agreement might be deemed frustrated by a supervening event which makes performance of the contract (1) impossible; (2) illegal; or (3) radically different from that originally envisioned by the parties.
- 14.1 Although the doctrine of frustration is well-established, it operates within rather narrow confines, for two principal reasons. The first is that the courts do not wish to allow a party to

⁸ OFSI Monetary Penalties Guidance, April 2021, section 3.7.

appeal to the doctrine of frustration in an effort to escape from what has proved to be a bad bargain: frustration is “*not lightly to be invoked to relieve contracting parties of the normal consequences of imprudent commercial bargains*”. The second is that parties to commercial contracts commonly make provision within their contract for the impact which various possible catastrophic events may have on their contractual obligations. Thus, force majeure clauses are frequently inserted into commercial contracts.

- 14.2 The doctrine of frustration will only apply if the matter is not expressly addressed by another provision in the EFET General Agreement. On that basis, as the force majeure clause in the EFET General Agreement covers delivery obligations, it is not possible to say that delivery obligations will be frustrated. However, as payment obligations are not covered by the force majeure clause, it may be possible to argue that payment obligations have been frustrated.
 - 14.3 The frustrating event must be an event that was not foreseen or foreseeable by the parties when they had entered into the agreement, and which occurs after the contract has been entered into.
 - 14.4 The date the EFET General Agreement was entered into is therefore relevant to foreseeability. In deciding whether foresight of foreseeability may exclude the ability of parties to discharge their performance under a contract for frustration, we note that the following factors must also be considered:
 - 14.4.1 the degree of foreseeability (i.e. whether the parties can reasonably be expected to foresee the occurrence of the event as a real likelihood);
 - 14.4.2 the extent of foreseeability (i.e. whether the full extent of the effects of the supervening event on the contract were foreseeable); and
 - 14.4.3 whether there are other indications that, even though the event was foreseen, it was not the intention of the parties or of one of them to assume the risk of its occurrence.
 - 14.5 Frustration has historically been very difficult to establish as a matter of English law. It would be a high standard to prove, and there is no guarantee of the ultimate outcome.
15. **In a scenario where a market participant has a gas purchase or sale agreement (EFET or non-standard terms) and sanctions come into force, which would prohibit payment according to the terms of the contract:**
- (i) **May parties amend the payment terms or vary the performance terms so that the parties can continue in a way that is compliant (i.e. by changing the currency from USD to Euro, alternative payment methods such as Escrow or Bank Guarantees).**

Response Date: 12.04.2022

Position under German law

- 15.1 From our perspective, this particularly addresses potential US sanction regimes.

- 15.2 As regards the amendment of other payment terms, we can in any case only comment on EFET standard terms and on any bespoke agreements.
- 15.3 Once a counterparty is listed on a sanctions list, it would need to be taken into account that the granting of an economic benefit would be forbidden under the sanction regimes.

Position under English law

- 15.4 This question relates to what is considered “new debt” or a “new contract” (in the context of pre-existing contracts).
- 15.5 OFAC FAQ 989 clarifies that, for the purposes of Directive 3 EO 14024, no material terms can be modified under the relevant contract or agreement, besides amendments to the reference rate referring to LIBOR.
- 15.6 In relation to position under UK sanctions, whilst there is currently no specific guidance on this point, based on past guidance relating to the concept of “new contracts” under other restrictions, a similar approach to that stated in OFAC FAQ 989 can be adopted.
- 15.7 Please also note that market participants that are subject to compliance with relevant sanctions are not permitted to be part of any arrangement the object or effect of which is to circumvent any relevant restriction under the relevant sanctions.

(ii) Is there any obligation on the parties to do this either in the EFET agreement or at law?

Position under German law

- 15.8 We would generally not expect such an obligation to amend contracts in a way to address/circumvent sanctions to exist in trading relationships. Specifically, we would not see such an obligation covered by the mitigation obligations under § 7 (3) of the EFET General Agreements and/or section 254 of the German Civil Code. Instead, this would require a mutual agreement for an amendment of the contract.

Position under English law

- 15.9 No, there is no obligation under the EFET General Agreements, or under English law on parties to amend payment terms or vary performance terms to address the effect of sanctions on existing contracts.

(iii) Would the requirement to use reasonable endeavors to overcome FM extend to a party being obliged to accept payment in non-contractual USD instead of contractual Euro?

Position under English law

- 15.10 In the recent case of *MUR Shipping BV v RTI Ltd* [2022] EWHC 467 (Comm), the English High Court considered whether the “reasonable endeavours” provision in a force majeure clause

would require a shipping owner that was prevented by sanctions from accepting USD payments from its counterparty, to accept its counterparty's proposal to make payment in Euros.

- 15.11 The judge held that the reasonable endeavours provision did not require the shipping owners to accept non-contractual performance, and did not oblige them to accept payment in Euros instead of U.S. Dollars.
- 15.12 This case should provide comfort that that the obligation on the Claiming Party to use reasonable endeavours to avoid or overcome Force Majeure under the EFET General Agreement does not require such party to accept or undertake performance outside the scope of what it had contractually agreed to perform. In particular, the Claiming Party would not be required to accept non-contractual performance by the other Party (e.g. payment in a currency other than Euro), if the Parties have agreed under § 13 (2) of the EFET General Agreement that payments shall be made in Euro.