

Frozen Out

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What relief does FIDIC provide when bank accounts are frozen as a result of war, hostilities, rebellion, terrorism etc.? Maybe not as much as you think.

Tensions in Africa and the Middle East have seen the implementation of numerous international financial sanctions. While these sanction regimes vary in execution and enforcement they often freeze assets and prevent financial transactions. These restrictions may impact on the Employer's performance of its payment obligations under the Contract. This can have serious consequences where the Contractor is entitled to suspend or terminate on notice for non-payment. Many parties automatically assume that financial sanctions will be recognized as force majeure. However, this may not be the case.

Contractual definition of Force Majeure

"Force Majeure" as defined under the FIDIC form of contract is strictly prescribed.

Clause 19.1 defines a Force Majeure event or circumstance as one which is "exceptional" and:

- (a) which is beyond a Party's control;
- (b) which such Party could not reasonably have provided against before entering into the Contract;
- (c) which, having arisen, such Party could not reasonably have avoided or overcome; and
- (d) which is not substantially attributable to the other Party.

Financial sanctions generally meet these requirements.

Clause 19.1 envisages a range of physical events or circumstances that may give rise to a Force Majeure if the above conditions are satisfied. These may include, but are not limited to, "exceptional" events or circumstances of the kind listed below, so long as conditions (a) to (d) above are satisfied:

- (i) war, hostilities (whether war be declared or not), invasion, act of foreign enemies, rebellion, terrorism, revolution, insurrection, military or usurped power, or civil war;



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- (ii) riot, commotion, disorder, strike or lockout by persons other than the Contractor's Personnel and other employees of the Contractor and Sub-Contractors;
- (iii) munitions of war, explosive materials, ionising radiation or contamination by radioactivity, except as may be attributable to the Contractor's use of such munitions, explosives, radiation or radioactivity; and
- (iv) natural catastrophes such as earthquake, hurricane, typhoon or volcanic activity.

However, clause 19.2 states:

"Notwithstanding any other provision of this Clause, Force Majeure shall not apply to obligations of either Party to make payments to the other Party under the Contract".

Therefore, it would appear that financial sanctions preventing the payments under the Contract are not covered by Force Majeure under the Contract. This could have serious consequences, as the Contractor



would be entitled to suspend or terminate on notice for non-payment under clauses 16.1 and 16.2

Clause 19.7

Clause 19.7 [*Release from Performance under the Law*] may offer a solution. It states (with emphasis added):

"Notwithstanding any other provision of this Clause, if any event or circumstance outside the control of the Parties (including, but not limited to, Force Majeure) arises which makes it impossible or unlawful for either or both Parties to fulfil its or their contractual obligations or which, under the law governing the Contract, entitles the Parties to be released from further performance of the Contract, then upon notice by either Party to the other Party of such event or circumstance:

- (a) the Parties shall be discharged from further performance, without prejudice to the rights of either Party in respect of any previous breach of the Contract, and
- (b) the sum payable by the Employer to the Contractor shall be the same as would have been payable under Sub-Clause 19.6 [*Optional Termination, Payment and Release*] if the Contract had been terminated under Sub-Clause 19.6.

It acts as a fall-back provision for extreme events outside of the parties control (i.e., events rendering contractual performance illegal or impossible) which do not fit within the strict definition of Force Majeure laid out under clause 19.1.

Impossible or Unlawful

The use of the words "impossible or unlawful" under clause 19.7 suggests a higher threshold than "prevention" under clause 19.2 is intended.

To claim it is impossible or unlawful it will not be enough for a party to establish that new circumstances have rendered its contractual performance merely more onerous or uneconomic. It must be actually and absolutely impossible or unlawful for the event or circumstance to excuse non-performance. If there is any way that a diligent party could have still performed its obligations then this clause will not apply.

Parties affected by the sanctions must therefore consider whether or not the sanction regime renders their contractual obligations actually and absolutely

impossible, or whether other measures could be taken that would allow performance under the Contract. It might be possible to circumvent the sanctions in some way. For example, depending on the sanction regime the sanctions may not apply to various branches and subsidiaries. Also, some countries (including the United Kingdom and the United States) have procedures in place for companies to request exemptions from the sanction regime. Further, some sanction regimes may exclude from their scope contractual obligations created before the conflict began. Finally, it may be possible to agree variations to the Contract to remedy the situation.

Of course, financial sanctions are often intended to apply for a limited time, and therefore the Employer's performance of its payment obligations under the Contract is not likely to be impossible permanently, only temporarily. If performance of the obligation can reasonably be suspended or deferred until the sanctions are lifted, a reasonable approach would be to excuse a party of the obligation temporarily from any liability for non- performance, as long as the sanctions are in place. Clause 14.8 could compensate the Contractor for non-payment in financing charges. However, Clause 19.7 does not envisage the temporary impossibility of the Employer's performance of its payment obligations under the Contract; there is clear reference to discharge from further performance and not mere suspension. Further, reference back to clause 19.6 requires the issue of a Payment Certificate and payment of such in the usual way.

Contractual Obligations

The next consideration is whether all of a party's contractual obligations must be impossible or unlawful to fulfil or whether just one or more will suffice, i.e. is it sufficient for the Employer merely to be unable to fulfil its payment obligations under the Contract?

There is authority which says that *"the provisions in clause 19.7 are expressly applicable to all obligations and can therefore be evoked where, for example, the employer's payment obligations are impeded by*



causes which fulfil ... 19.7".¹

The view that not all contractual obligations need to be impossible or unlawful is supported in the case of *Codelfa Construction Pty Limited v SRA of New South Wales* (1982)² where the court held that the contract had been frustrated by an injunction against night time working which restricted the contractor's inability to perform his time obligations under the contract (where time was made of the essence).

This approach is also favoured in other standard form documents. For example, the ICC Force Majeure Clause 2003 applies "*where a party to a contract fails to perform one or more of its contractual duties*".

Under the Governing Law of the Contract

The governing law of the Contract may itself make provision for force majeure quite independently from the Contract. This is more common in civil law jurisdictions than common law jurisdictions.

Shall be Discharged from Further Performance

Only in these extreme cases does clause 19.7 envisage that (upon notice) the Parties will be discharged from further performance of the Contract. Read with clause 19.6 [*Optional Termination*] it seems likely that this means that the parties are discharged from all further performance including that which has not been affected by the impossibility or unlawfulness.

Conclusion

In summary, parties to a FIDIC contract must not assume that Force Majeure will automatically excuse them from their respective payment obligations under the Contract in the event of financial sanctions.

Please get in touch at victoria.tyson@howardkennedy.com with your thoughts or to discuss any concern

¹ Samuelsson and Iwar, *FIDIC an analysis of international contracts* (2005) Kluwer International Law at pp. 298-299

² 149 CLR 337.

