



# Moving the goalposts

**ROBERT PARSON** highlights the risk of non-repayment as a result of sanctions-related issues in trade finance transactions and suggests some precautions

**W**e are hearing plenty of competing views right now about whether what the global economy (and in particular the eurozone) needs is a relaxation of the supply and circulation of money to stimulate growth – argued passionately by thousands in the streets of Athens and elsewhere – or three years of hard labour to instil the financial rigour needed to sustain future growth (enthused over by a diminishing group).

While the television headlines are inevitably (and rightly) grabbed by strikers, reductions in frontline services in health, policing and social care, much of the avoidable damage to global wealth creation and prosperity is, according to some observers, being done off camera.

When G7 leaders meeting in Rome in February 2009 stepped up in turn to stress the need to “support emerging and developing countries’ access to credit and trade financing” they omitted to qualify that by reference to the package of changes rapidly unfolding under Basel III. These include the increased credit conversion factor (CCF) value applied to most trade letters of credit which would directly challenge the G7 leaders’ well-meaning

aspiration by actively restricting access to credit and trade financing. They also failed to mention that it was an aspiration which would have to fit, rather uncomfortably at times, alongside individual foreign policy ambitions of some G7 nations. These are governments that have for years recognised the ability to restrict access to international trade by means of trade and economic sanctions is one of the most potent (and non-violent) means of persuasion/attrition known to man. Although statistically less than five per cent of the major trade sanctions ever established worldwide can be said to have achieved the hoped for political result, they remain an ever more constant part of a trader’s and a trader’s bank’s life.

## **Punishing the innocent**

Sadly, the sanctions imposed by the UN, EU and individual nations more often than not fail to punish the real wrongdoers whose actions (often themselves horrific) have visited the sanctions upon their long suffering and innocent countrymen. Those with money, contacts and guile generally find a way to avoid the worst privations of economic sanctions. The hands of those imposing sanctions are not always spotless either. The story of how the cigar-loving

US president John F Kennedy sent his media chief out to buy up 1,200 Cuban cigars the night before signing the first Cuban sanctions on 3 February is well known. However, even that impressive haul was insufficient to keep successive occupants of the White House in stogies for the 50 years of Cuban sanctions that have followed.

## **Impact on trade finance**

Sanctions are clearly here to stay and are on the increase as a favoured tool of unarmed foreign intervention. Images of hungry people in food queues or hospitals short of medical supplies are, from a political perspective, easier on the eye for CNN than scenes of civilian casualties caused by direct foreign military intervention. The impatience of certain countries, notably the USA, with the UN process – particularly since the last Iraq war and the Syrian experience, has also seen an increase in the number of unilateral sanctions established.

Banks, particularly those exposed to either direct or indirect regulatory control in the USA, are naturally anxious not to breach any sanctions provision, but at the same time they need to avoid losing the confidence of their customers in their

services and products. Buyers tasked with establishing a letter of credit (LC) as payment or security for payment under the terms of their contracts may well encounter problems with their banks if any aspect of the transaction hits the bank's radar as potentially an infringement of a relevant sanctions order.<sup>1</sup>

Some banks began to clause the LCs they issued with wording that would simply restate the law – by stating that like any

sanctions where a number of issuing banks were caught out and a fresh guidance from the ICC is expected soon.

Of interest here is that once an issuing bank has incurred a payment obligation to a non-sanctioned party (for example a confirming bank) the satisfaction of that obligation will not generally be a breach of sanctions. Where some issuing banks came unstuck, however, was that the operational consequences of the

the issuing bank is therefore purely the collection of the debt which the issuing bank has, in effect, guaranteed through issuing the standby credit. There may be no actual breach of sanctions by the bank honouring its payment obligation at this stage but, again, the presence of an appropriately worded sanctions clause (particularly one affording the bank a degree of discretion) if the beneficiary is unwise enough to accept it, could give the issuing bank a convenient escape route if it then finds itself out of funds from the customer. Documentary credit payments can be somewhat more complex. A licence is usually needed as the act of submitting original shipping documents for payment may well cause a breach of the sanctions. The terms of the particular sanctions order would need to be carefully examined.

Faced with any wording in a letter of credit which purports to give the issuing bank the right to withhold payment for sanctions-related issues the beneficiary should exercise extreme caution. At best the wording will be unnecessary – because a clause that merely states the law adds nothing – and at worst the wording may seriously undermine and dilute the issuing bank's payment obligation. A contractual clause prohibiting the addition of any sanctions wording in an LC issued on behalf of the buyer gives some degree of protection but diligence at the time of issuance is key. Once the goods are shipped the LC may represent the only, or only convenient, way to get paid.

#### Reference:

1. [www.tfreview.com/feature/legal-regulatory/not-national-interest-dealing-sanctions](http://www.tfreview.com/feature/legal-regulatory/not-national-interest-dealing-sanctions)

Robert Parson is a partner in the energy and natural resources group of law firm Reed Smith  
[rparson@reedsmith.com](mailto:rparson@reedsmith.com)

## **“Banks, particularly those exposed to either direct or indirect regulatory control in the USA, are naturally anxious not to breach any sanctions provision, but at the same time they need to avoid losing the confidence of their customers in their services and products”**

other institution they would have to obey whatever sanctions were incorporated into local law. Others would state that they would refuse to pay if their own internal policies required them to follow the sanctions imposed in another country (for example, the USA) and others would simply reserve the right not to pay if they, in their discretion, thought that payment might be in breach of sanctions. Given that the intention of the LC, be it documentary or standby, is to provide substantial certainty to the seller in terms of the recovery of the sale price, this movement of the contractual goalposts is clearly undesirable.

#### ICC guidance

Dissatisfaction with this state of affairs from traders led to the International Chamber of Commerce (ICC) issuing the ICC Guidance paper (470/1129, March 2010) which called on banks to abandon the practice of clausing credits. However the practice appears to have come back with renewed vigour since the Libyan

sanctions – particularly in the case of banks providing finance for the Libyan state-owned industries – meant that they could no longer physically collect their reimbursement from customers to whom they had extended credit and in circumstances where they had paid out under either documentary or standby credits. The presence of a sanctions clause would, in many cases, have saved them from having to reimburse the confirming bank at all – often in respect of huge amounts. So in times of poor liquidity in the market the motivation for including sanctions wording in a letter of credit may not only be a desire to stand in line with US policy – self preservation may also be a factor.

#### Contractual behaviour

In cases where standby letters of credit are issued, the underlying contractual behaviour that might have contravened newly-issued sanctions will very often have taken place weeks earlier and the claim on



## SPECIAL SUBSCRIPTION OFFER – 15% DISCOUNT

Trade & Forfeiting Review offers industry leading intelligence on trade finance, keeping you ahead of your competition in global trade markets.

Subscribe today for only £335.75 – saving over £60.



Simply call +44(0)20 7566 8210

or email [jsnodin@wilmington.co.uk](mailto:jsnodin@wilmington.co.uk) quoting reference TFR11-15.8

