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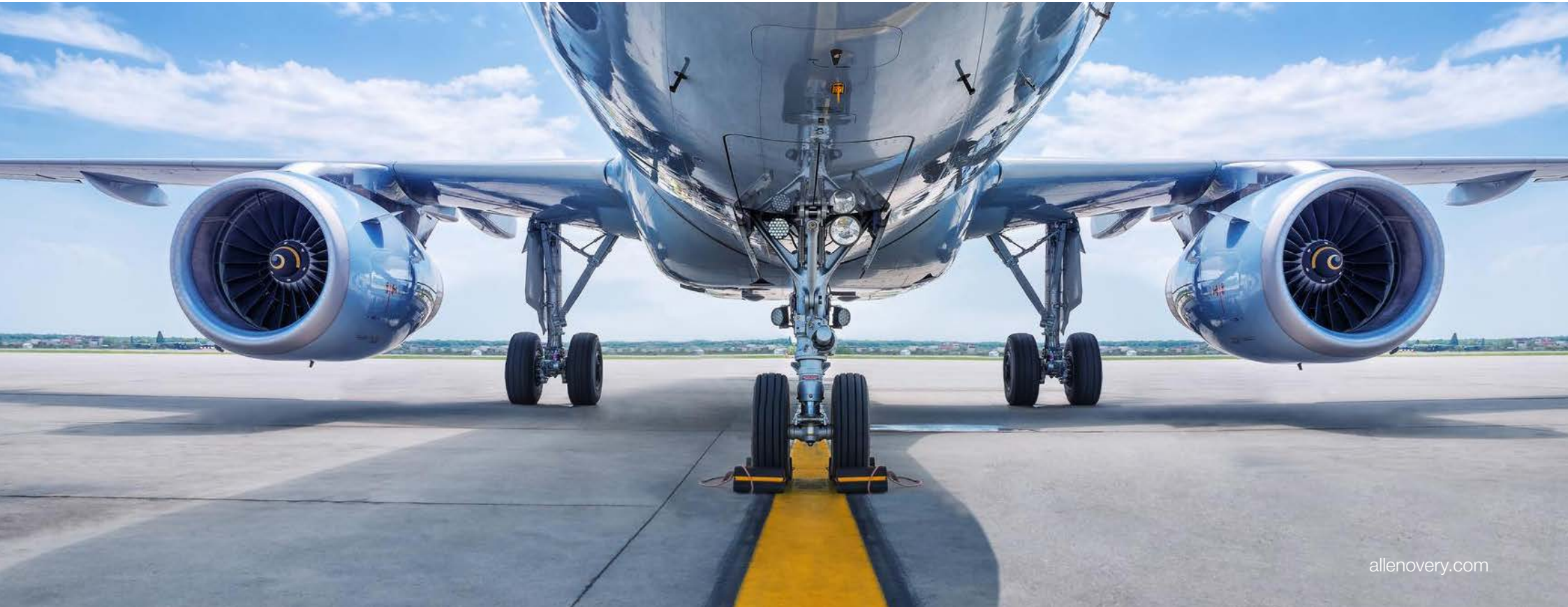
Sanctions and the no re-export to Russia requirements



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Overview

On 18 December 2023, the EU adopted its 12th package of sanctions against Russia. This package included Council Regulation 2023/2878 (the **Regulation**), which amended Regulation (EU) 833/2014 (**Regulation 833**). The Regulation extended the sanctions regime imposed on Russia by, amongst other matters, imposing further restrictions concerning contracts and the re-export of certain goods, including aircraft, to Russia (the **Article 12g Sanctions**). The European Commission published six FAQs on the Article 12g Sanctions on 22 February 2024 (the **FAQs**).

As the FAQs note, the purpose of the Article 12g Sanctions is to combat the circumvention of EU export bans and, more specifically, the situation where certain goods, including aircraft, are exported to third countries and then simply re-exported to Russia.

This briefing discusses these Article 12g Sanctions and FAQs, and the extent that they impact upon sales and leases of aircraft and certain parts thereof in particular (which we refer to below simply as **aircraft**).

The Article 12g Sanctions apply to EU persons which are entering into certain types of contracts as exporters. The contracts potentially affected are those which see EU person exporters sell, supply, transfer, or export aircraft to third countries (being non-EU countries) other than certain "**partner countries**". These are, at present, the USA, UK, Japan, South Korea, Australia, Canada, New Zealand, Norway and Switzerland. The Article 12g Sanctions use the term **exporter** to refer to the EU person selling, supplying, transferring, or exporting the aircraft and the term **third-country counterpart** to refer to the person in a non-partner country buying, receiving the supply/transfer or importing.

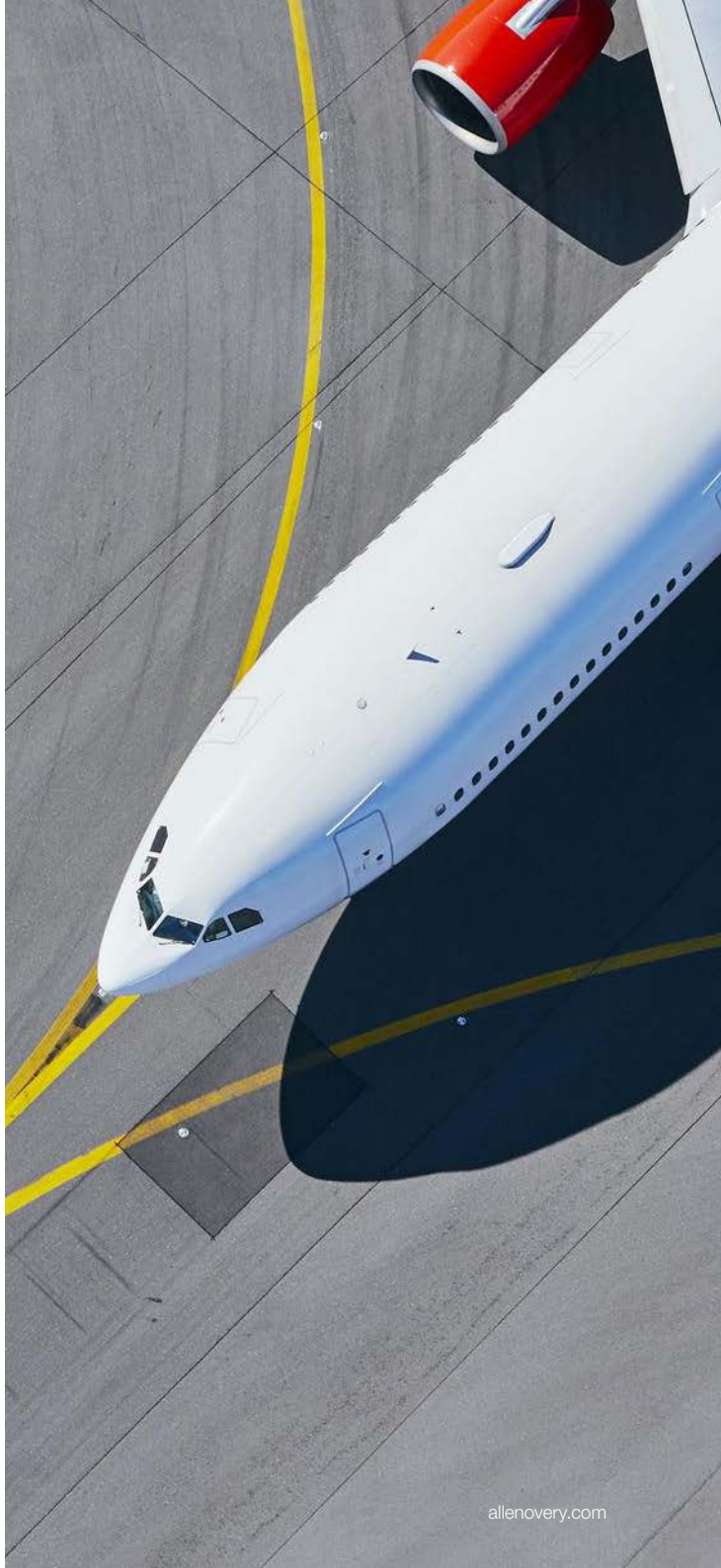
The requirements generally apply from 20 March 2024. However, for contracts that were concluded prior to 19 December 2023 (i.e. before the coming into force of the Article 12g Sanctions), the requirements will only apply from 20 December 2024 (if the contracts in question have not already expired at that point).

There are three requirements:

1. an EU person exporter (as exporter) is required to include contractual provisions which prohibit the further re-export of the goods to Russia or for use in Russia by their counterparty (a **no-Russia clause**);
2. such an exporter must ensure that their contract provides them with 'adequate remedies' if their counterparty (as a third-country counterpart) breaches the no-Russia clause; and
3. the exporter must inform the authorities responsible for monitoring sanctions compliance in their jurisdiction of any breach of any no-Russia clause.

Member States must further share information with each other and to the European Commission regarding any detected breaches or circumventions of such non-Russia clauses.

Of course, the devil is in the detail. We discuss some of these details below.



The detail

Who has to comply with the Regulation?

The Regulation only applies to EU person exporters who are selling, supplying, transferring, or exporting the targeted goods (including aircraft) to third-country counterparts outside of the EU but who themselves are not in a partner country.

Affected exporters will include airlines and operating lessors located in any EU Member State, and also any special purpose companies established or resident in an EU Member State for leasing aircraft in structured transactions (Ireland is a favoured location for such special purpose companies).

At present neither the UK nor the U.S. has introduced a corresponding amendment to their sanctions regimes.

Must the document contain a single clause prohibiting export to Russia?

The Regulation simply states that the exporter must contractually prohibit re-exportation to, or for use in, Russia. A clause expressly stating 'thou shalt not export the aircraft to Russia' is not believed to be necessary so long as the provisions of the document, when taken together, clearly prohibit the aircraft being re-exported to, or for use in, Russia. This is confirmed by FAQ 6, which notes that "Operators are free to choose the appropriate wording for the "no re-export to Russia" clause, as long as the outcome fulfils the requirements of Article 12g.". FAQ 6 does, however, include a "model clause" which could be used as a reasonable starting point.

Must the restriction in the contractual documentation expressly mention Russia or is it sufficient to simply refer to countries sanctioned by the EU?

A clause that prohibits a third-country counterpart from re-exporting an aircraft to any "Sanctioned Country" (or similar) could potentially be a valid no-Russia clause, subject to precisely how widely the "Sanctioned Country" definition has been scoped within the contract in question. For example, if this definition covers any country that is, or whose government is, targeted with EU trade, economic or financial sanctions, it should cover Russia; but if it only covers countries targeted with so-called "comprehensive" EU, UK or U.S. trade, economic, or financial sanctions (eg as at the date of this briefing, understood to be Iran, North Korea, Syria, Cuba, Luhansk, Donetsk, and Crimea), it will not.

What else should a no-Russia clause contain

The Article 12g Sanctions are not prescriptive as to what the no-Russia clause should look like. FAQ 6's model clause suggests, however, that the following additional points could be included:

– an undertaking from the third-country counterpart that it will use best efforts to ensure that the purpose of the no-Russia clause is not frustrated by any third parties further down the commercial chain, including by possible resellers;

– an undertaking from the third-country counterparty that it will set up and maintain an adequate monitoring mechanism to detect conduct by any third parties further down the commercial chain, including by possible resellers, that would frustrate the no-Russia clause; and

– an information covenant, requiring the third-country counterparty to inform the exporter if it becomes aware of breaches

of the aforementioned two clauses or the no-Russia clause itself, or if it is otherwise requested for information by the exporter.

It further recommends explicitly confirming that the no-Russia clause is identified as an "essential element of the contract". In the context of English law this means making sure the clause is identified as a condition of the contract.

What sorts of transactions are caught by 'sell, supply, transfer or export'?

The requirement to establish a no-Russia clause with associated adequate remedy is applicable to contracts of EU person exporters which involve any "selling, supplying, transferring, or exporting". These latter concepts would typically include not only sales agreements, but also any form of lease, hire purchase or, potentially, conditional sale agreement. Other forms of transfer such as gifts or barter would also likely be caught. Providing the services of an aircraft under a wet-lease or charter arrangement would also likely constitute a supply.

We do see a technical argument that the Article 12g Sanctions only apply to EU exporters, and hence only exports should be treated as covered. However, this does not appear to be the intention or purpose of the drafting of the Article 12g Sanctions (which explicitly refers to sales, supplies, transfers, and exports), and so we prefer the view that all forms are covered.

We consider the Article 12g regime targets both re-exports made by the third-country counterpart pursuant to sales agreements entered into by the third-country counterpart (acting as seller) and, in a leasing context, subleases entered into by the third-country counterpart (acting as lessor).

What is an adequate remedy?

This is a key question. Only limited guidance has yet been produced on this topic, most notably that as set out in FAQs 5 and 6. FAQ 5 notes, simply, that the remedies "*should be reasonably strong and aim to deter non-EU operators from any breaches. They can include, for instance, termination of the contract and the payment of a penalty*." The same principles are repeated in FAQ 6 (which itself stops short of suggesting at what level any penalty should be set).

In the absence of any material guidance from the EU, an adequate remedy could reasonably be understood to mean one that either prevents export or otherwise sufficiently disincentivises, or could be reasonably expected to sufficiently disincentivise, a third-country counterpart from re-exporting the aircraft to Russia.

It is worth bearing in mind when considering what an adequate remedy is that no contractual remedy will prevent a party intent on breaching the contract or engaging in illegal activity from doing so.

It is also worth bearing in mind that, once the aircraft has been re-exported to Russia, there is little that can be done to get the aircraft back, as evidenced by the loss of over 100 leased aircraft following the Russian invasion of Ukraine.

One question to consider is whether some kind of specific provisions are required to be inserted into the contract to create an "adequate remedy", or whether the natural remedy of damages (as potentially supplemented by other available remedies, such as a court order for specific performance) for breach of the no-Russia clause by the third-country counterpart would be sufficient in and of itself. The answer to even this question is not simple, and it would, ultimately, be one for the courts to decide in any given case (however, the regulator's views will, in most cases, perhaps be of more concern). However, in our view, it will be influenced by factors such as:

(a) how the governing law and jurisdictional clauses of the contract have been set, and what they provide for (eg if it's Russian law or the Russian courts, the relevant non-Russia clause may not be recognised at all; in which case it is doubtful that an "adequate remedy" would exist for its breach; eg what can actually be claimed, and what wider steps can be taken, by the EU person exporter, and in what circumstances);

(b) the known status and financial condition of the third-country counterpart (eg whether the third-country counterpart can be reasonably expected to have the funds available to it to pay any damages that it

becomes obligated to pay pursuant to any breach of the no-Russia clause); and

(c) where the contract has been "completed", whether the mechanics creating the remedy have "survived" (if they have not, the remedy is unlikely to be adequate).

An additional issue for an EU person exporter is that, in order to claim any damages, it will first need to incur losses (ie putting the financial risk on it). It is not known if this would impact upon the "adequacy" of the remedy or not for the purposes of the Article 12g Sanctions, but it is an important practical consideration.

Ideally, the adequate remedy would be more tailored, and would provide a wider range of options to the EU person exporter. One possible construct could involve, for example, a contractual right to be able to instruct the third-country counterpart to use best endeavours to return the aircraft from Russia. Another may be to create an indemnity mechanic, which says that, if the third-country counterpart is in violation of a no-Russia clause, it will cover any and all defined losses arising from the same (allowing the exporter the advantages of the indemnity mechanics over standard damages for a contractual breach). A third could be a "damages clause" (discussed further below). Other mechanisms may exist. Combinations of mechanisms would be favoured (and would likely enhance the ability of the EU person exporter to defend the "adequacy" of the measures it has put in place in any given case).

Could a "damages clause" be used?

An adequate remedy structure could potentially seek to make use of a "damages clause" or similar, effectively compelling the third-country counterpart to pay a sum (or provide some other asset) to the exporter if the third-country counterpart violates the no-Russia clause. Indeed, FAQs 5 and 6 both suggest that such a clause could be used.

Indeed, the EU's model clause at FAQ 6 indicates the penalty clause could be set to "a penalty of [XX]% of the total value of this Agreement or price of the goods exported, whichever is higher".

In English law governed contracts, care will need to be taken, however, to ensure that any such clause does not constitute a "penalty clause", which would be unenforceable (and so not adequate!). A careful balance would need to be struck to help ensure that any such "damages clause" reflected a legitimate interest of the exporter, and was proportionate in context. What the legitimate interest of the exporter would be in this situation and whether the amount of damages selected in the contract would be proportionate would, ultimately, be questions to be considered on a case-by-case basis. Careful drafting will minimise the risk of a remedy being deemed a penalty, but it cannot be completely removed.

Is there a penalty for the exporter if they fail to have an effective no-Russia clause?

Potentially yes. Member States are obligated to lay down the rules on penalties which become applicable to exporters (ie lessors) who infringe these provisions, which penalties must be effective, proportionate and dissuasive. Lessors should consider the precise penalties that are applicable to them by reference to the relevant Member State's laws concerned (Irish lessors should, for example, check Irish domestic implementing legislation etc.).

Can an exporter amend an existing contract to incorporate a no-Russia clause?

While inserting a no-Russia clause with adequate remedies in a new contract is straightforward, existing contracts are more of a challenge. English law does not permit one party to make unilateral changes to the contract without the other party's agreement. Entering into negotiations with the lessee might resolve the problem, but certain airlines may potentially seek to exact a price for any amendments to a lease that benefits the lessor.

In cases where the lessee's demands are onerous or where the lessee simply refuses to engage at all, further consideration should be given to any existing agreement's illegality provisions, to see what rights (if any) are provided for through the same.

We do not expect the UK government to change the law to amend contracts compulsorily if parties cannot agree changes.

Is there a penalty for the exporter if there is a re-export to Russia in contravention of the no-Russia clause?

No. However, the exporter would be obligated in these circumstances to inform the competent authority of the Member State where they are resident. Assuming that this is done, it can be reasonably anticipated that the Member State in question may ask what the "adequate remedy" is, and how it will subsequently be used by the exporter (possibly with a focus on what can be done to get the aircraft returned). This could be expected to lead to heavy scrutiny of what the lessor has put in place for its "adequate remedy" and its no-Russia clause in general, and their adequacy (or otherwise). The European Commission is currently harmonising the criminal offences and penalties for the violation of EU sanctions across Member States.

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