

# Elections and Russian sanctions: a salutary reminder of the perils of inconsistent rights

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March 24, 2023   Andreas Dracoulis

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**PRACTICES** International, Shipping, Litigation

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This is a case that provides an interesting and informative analysis of English law's approach where a party is presented with inconsistent courses of action under a contract. The case was also decided against the backdrop of the EU sanctions regime related to Russia's invasion of Ukraine.

## *Background*

The Havila Group in Norway required coastal passenger vessels and had arranged for four vessels to be constructed at a Turkish shipyard. These vessels would be put in to service under long term charters to the Norwegian Ministry of Transport. At the time of the judgment, two of the vessels were completed and in service and two were still under construction. The Havila Group financed part of the build cost itself. The balance was provided by indirect subsidiaries of a Russian State-owned and controlled financing house. The financing structure was based on a lease financing model, with back-to-back sales and bareboat charters.

Essentially, the Claimants in this action were the two Havila Group entities named as lessees in the bareboat charters for the two vessels still under construction – and we refer to those entities together as “Havila”; and the Defendants in this action were the two indirect subsidiaries of the Russian financing house named as lessors in those bareboat charters – and we refer to those entities together as “STLC”. The subject matter of this judgment is therefore the two vessels still under construction, however the findings are relevant to all four vessels.

The related contractual arrangements between the parties are complex and arise under three agreements related to: the sale of the vessels (the MOAs); the bareboat charters; and the security agreement for each vessel (the pre-delivery security assignments).

On 8 April 2022 the Russian State-owned entity became subject to the EU sanctions regime related to Russia's invasion of Ukraine. That sanctions regime also covered STLC, as indirect subsidiaries. It was the imposition of these sanctions which gave rise to this dispute.

## *Was there a Termination Event?*

Presumably out of concerns as to the long-term viability of the bareboat structure in light of the sanctions, STLC sought to terminate the contractual arrangement for all four vessels. It did so on the basis that, in short, there had been a change in identity of the purchasing entity under the relevant shipbuilding contract for one of the vessels already in service. In principle, that was sufficient to constitute a “Termination Event” giving STLC rights to terminate the bareboat charters for all four vessels. However, the change had been made by Havila in response to the sanctions. There was therefore disagreement about whether it was a valid Termination Event, because the bareboat charters contained a sanctions clause (which meant that neither party was obliged to do anything that would constitute a breach of any sanctions). In this respect, the court took the view that the existence of a sanctions clause did not alter “the existence of a state of affairs” (i.e. the

change in identity) and so could not affect the contractual consequences of that change in identity. This was the case even though the act of making the change in identity appeared to have been carried out in mitigation of the problems created by the sanctions. In the court's view, that was not relevant to the analysis of this issue. The Termination Event therefore existed.

### *The options available following the Termination Event*

However, it was how STLC then acted upon the Termination Event that generated the substantive issues in dispute. There were a number of options open to STLC following the Termination Event. One of the options was to terminate the bareboat charters with immediate effect and retain ownership of the vessels – the court referred to this as foreclosure. A second option was to demand payment of prescribed “Termination Sums” following which ownership of the vessels would be transferred to Havila – this was referred to as the transfer of title mechanism. STLC elected to use the transfer of title mechanism, however the bank account in Ireland nominated by STLC to receive the Termination Sums was at some subsequent point frozen as a consequence of the sanctions. As such, STLC had chosen a contractual pathway that would lead to transfer of the vessels to Havila but without any ability to access the funds paid to it by Havila by way of compensation.

Not surprisingly, by the time of the hearing in this matter, STLC were seeking to argue that they could exercise the foreclosure option – indeed it appears that STLC had attempted to take steps to take over the shipbuilding contracts for the two vessels still under construction. Additionally, STLC sought to argue that payment of the Termination Sums into a frozen account would not amount to a good discharge of Havila's liability.

### *The election issue – could STLC now exercise the foreclosure option?*

The question for the court was whether, having initially elected to pursue the transfer of title mechanism, STLC could now change their minds and seek to pursue the foreclosure option.

The court looked at a number of the options that became available to STLC under the bareboat charters upon the occurrence of a Termination Event and found that some of them were manifestly contradictory or mutually exclusive. And that was the finding that the court made as between the foreclosure option and the transfer of title mechanism. In the court's view, it was beyond question that those provisions contained inconsistent and mutually exclusive options. This was because foreclosure involved choosing to terminate the bareboat charters such that STLC would retain ownership of the vessels. That was found to be entirely incompatible with the transfer of title mechanism, which specifically operated in a way that kept the bareboat charters alive and conferred a contingent right to title in the vessels upon payment of the Termination Sums.

In short, the transfer of title provisions involved an affirmation of the contracts, whereas the foreclosure mechanism would bring the bareboat charters to an end. In the Court's view it was not open to STLC to choose both of those courses of action in the same legal breath – the Court thought that would be paradoxical and nonsensical. The upshot was that STLC had to choose one or the other, which seems to us to be the correct conclusion. It is not dissimilar to the position where a party has a right to accept a repudiatory breach as bringing a contract to an end alongside a contractual right to terminate – if those two rights are incompatible, then the party would not be able to pursue both routes.

The Court then went on to consider what would happen if Havila did not pay the Termination Sums “immediately”, as they were required to do. On the facts, Havila had not made payment immediately. This was because they had to arrange financing in order to do so and they also had to

obtain approval to make payment to a sanctioned entity. However, a failure to make payment immediately was itself a fresh Termination Event that would, in principle, entitle STLC to make a further election as between foreclosure and the transfer of title mechanism. For reasons that are not clear from the judgment, STLC had not yet sought to exercise their right to foreclose and, by the time of this judgment, several months later, the court took the view that it was not open to STLC to do so. In the court's view, and while Havila was required to make immediate payment, that did not mean instantaneous or even the same day (there were provisions in the bareboat charters that talked about payment being made within five business days of notice of the relevant bank account). The key point, however, was that Havila had not been able to make payment because the court found that they reasonably believed that in doing so there might be a breach of the sanctions regime. As such, and in this context, the existence of the sanctions clause would assist Havila, i.e. it would relieve Havila of liability in failing to make immediate payment. That in turn meant that it was not open to STLC to elect to pursue the foreclosure option.

Accordingly: STLC's election to pursue the transfer of title mechanism remained valid; Havila was not in breach of its payment obligation because of the effect of the sanctions clause; and STLC, having made an election to pursue the transfer of title mechanism, could not then make a contrary election to foreclose.

*Was payment into a frozen account a good discharge of Havila's liability?*

On the basis of the wording of the contractual provisions, the court found that payment into the account nominated by STLC would, despite that account being frozen, constitute receipt by STLC and therefore a good discharge by Havila of its obligations under the transfer of title mechanism.

STLC had sought to rely upon case law suggesting that a recipient of funds had a right to the immediate use of those funds. However, the court took the view (correctly in our opinion) that this was not what the contractual provisions agreed between the parties meant. Those provisions simply provided for payment to be made into the bank account so nominated. Whether STLC was actually able to get access to the funds was, in the Court's view, immaterial to the contractual analysis.

*What else could STLC have done?*

STLC are now in a difficult position. They are committed to a contractual mechanism that will mean that payment for vessels that they have financed in very substantial part will be made into a frozen bank account. As such, they will not get access to the funds upon payment by Havila and it is not clear when (or indeed if) they will in the future. Without knowing the full facts it is difficult to say whether a different approach would have been more advantageous to STLC. However, had STLC elected to use the foreclosure option from the outset, that might well have put them in a better position – although it is possible that the sanctions regime may yet have affected their ability to deal with the vessels.

It is also noteworthy that there has been a further judgment in this dispute (handed down at the end of February 2023) dealing with matters relevant to the assessment of the Termination Sums for the two vessels under construction. It therefore appears that Havila will in due course be in a position to make payment of the Termination Sums, following which they will secure good title to the vessels despite the fact that STLC will not be able to access the funds for as long the nominated bank account remains frozen.