English Court Considers if U.S. Controlled Marine Insurers Must Pay Claim in Light of Sanctions

Mamancochet Mining Limited v Aegis Managing Agency Limited and Others[1]

In this important recent marine insurance case, London based but U.S. controlled insurers were ordered by an English court to pay a cargo insurance claim concerning Iran, under a policy governed by English Law, because the following standard London Market sanctions exclusion clause did not provide them with a defense:

> No (re)insurers shall be deemed to provide cover and no (re)insurer shall be liable to pay any claim or provide any benefit hereunder to the extent that the provision of such cover, payment of such claim or provision of such benefit would expose that (re)insurer to any sanction, prohibition or restriction under United Nations resolutions the trade or economic sanctions, laws, or regulations of the European Union, United Kingdom or the United States of America. (the Sanctions Exclusion).

The case is also of interest, and unusual, because the English court had to consider the true construction of U.S. sanctions legislation.

Loss

The claimant was the assignee of the benefit of a marine cargo policy governed by English law. The policy was subscribed to by 11 of the defendants who had agreed to cover Metalloyd (the insured) against the risk of theft of cargo being shipped from Russia to Iran in August 2012. The cargo was stolen from a bonded warehouse after arrival in Iran, in September 2012. A claim was made under the insurance policy on or around 8 March 2013.

U.S. Iranian Sanctions on Foreign Entities Owned or Controlled by U.S. Persons

All of the defendants were insurers owned or controlled by U.S. entities. For the purposes of U.S. sanction laws, each was a "US owned or controlled foreign entity" (USCFE). At the time the policy was entered into, no relevant sanctions prohibited the defendants from issuing the policy, however on 22 October 2012, i.e. after the insured loss had occurred, President Obama promulgated the following rule to the Iranian Transaction and Sanctions Regulations[2] (ITSR) prohibiting transactions with Iran by USCFEs:

> 560.215 Prohibitions on Foreign Entities Owned or Controlled by US Persons
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> (a) … an entity that is owned or controlled by a United States person and established or maintained outside the United States is prohibited from knowingly engaging in any transaction, directly or indirectly, with the Government of Iran or any person subject to the jurisdiction of the Government of Iran that would be prohibited pursuant to this part if engaged in by a United States person or on the United States.

This section came into effect from 8 March 2013. Accordingly, nine of the defendants would have been prohibited from paying a claim under the policy, because the claim was submitted after it came into effect.

In 2015-2016, the regulatory landscape changed again with the implementation of the Joint Comprehensive Plan of Action (JCPOA) on 16 January 2016. This provided that Iran was to receive relief from various international sanctions in return for making some commitments in relation to

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The United States gave effect to the commitment set out in the JCPOA by General License H. This formed part of the ITSR and provided a relaxation of sanctions subject to certain exceptions. With effect from 16 January 2016, USCFEs were entitled to engage in all activities consistent with the JCPOA including the provision of insurance and reinsurance services.

However, on 8 May 2018, President Trump announced the withdrawal of the United States from the JCPOA to come into full force after 5 November 2018. General License H was revoked from 27 June 2018, subject to a new wind-down provision, section 560.537, introduced into the ITSR. It was not disputed by the parties that, absent a specific license, the defendants were prohibited by the ITSR from paying the claim under the policy on or after 5 November 2018.

Construction of the Sanctions Exclusion Clause

The defendant insurers submitted that the Sanctions Exclusion provided that they were not liable to pay the claim if they were **at risk** of being sanctioned by OFAC for paying a claim under the policy before 5 November 2018. That, they said, was what was meant by "exposure" to any sanction. They argued that, for the exclusion to operate, it was sufficient that the sanctions enforcing agency (OFAC in this case) **might conclude there was prohibited conduct** and may impose a sanction, even though under a proper interpretation of the sanctions law there might not, in fact, have been a breach.

In contrast, the claimant submitted that for the Sanctions Exclusion to operate, defendant insurers needed to establish, on the balance of probabilities, that payment **would put them** in breach of the application sanctions and that would lawfully expose them to sanction.

Having considered English rules of policy construction, the court rejected the defendants' argument that merely being **at risk** of sanction was sufficient to bring the sanctions exclusion into play. Mr. Justice Teare concluded that: "the language and context of the clause show that the meaning of the clause which would be conveyed to a reasonable person is as follows. The clause provides that the insurer is not liable to pay a claim where payment would be prohibited under one of the named systems of law and thus "would expose" the Defendant to a sanction."

Whether U.S. Sanctions Prohibited Payment

In light of its finding on policy construction, the court then had to consider the meaning and effect of ITSR s.560.215. Under English procedure, matters of foreign law are treated as questions of fact. Accordingly, the court heard evidence from two U.S. legal experts. Those experts disagreed over the central issue of whether or not payment of the claim would be prohibited during the wind-down period of the sanctions, in circumstances where the loss occurred before the effective date of General License H. The court, therefore, had to exercise its own judgment in construing the U.S. legislation.

By considering the "plain meaning" of the wind-down provision in ITSR s.560 that sought to re-apply sanction on Iran, as well as OFAC's FAQs the court concluded that payment of the claim before 11:59 on 4 November 2018 would not be prohibited by U.S. law, and therefore would not expose the defendants to sanction.

It, therefore, followed that the sanctions exclusion clause did not prohibit payment of the insurance claim by dint of U.S. sanctions. That was the central finding of the judgment.

Whether Refusal of Authority to Confirm Position "Would Expose" Insurer to Sanctions

It was submitted by the defendant insurers that where relevant enforcement authorities refuse to confirm that payment of a claim can safely be made, the defendants remained exposed to sanction or the risk of sanction. In the court's view, "such failure or refusal cannot 'expose' the defendants to sanctions on the construction of the sanctions clause which I have held to be correct."

Whether the Sanctions Exclusion Clause Suspends or Extinguishes Liability for a Claim

The defendant insurers submitted that once the sanctions clause was triggered, its effect was to extinguish any liability of the defendants to pay the claim. If that was the correct position, then, as soon as the claim had been presented (which was agreed to be after 8 March 2013) the claim would have been immediately and forever extinguished, because at the time it was presented payment was prohibited and so the defendants were exposed to sanctions.

The court disagreed, saying: "There is nothing in the sanctions clause which purports to extinguish a claim. Rather, the clause provides that "to the extent that" payment of such a claim would expose the insurer to sanction, the insurer will not be liable to pay." The clause was held merely to suspend liability for such time as relevant sanctions are in force. Defendant insurers objected to this approach, arguing that it would lead to open-ended liability. The court concluded that was indeed the case, subject to effect of limitation, adding that: "if proceedings are commenced (to stop the limitation period running, I see no difficulty in staying the claim (during the period when liability to pay is suspended) and then lifting the stay (when the sanctions are relaxed) so as to permit the claim to be paid." The defendant insurers, who were no doubt thinking about reserving, argued that such an approach would be undesirable and uncommercial. The court disagreed.

EU Sanctions

It was common ground that payment of the claim after 21 December 2012 was not prohibited by EU sanctions, which had been relaxed in light of the Joint Comprehensive Plan of Action.

Irrelevance of EU Blocking Regulation[3] — *Obiter*

Although this point did not arise for formal determination, the court's comments on this are important. It is the first judicial comment on the inter-relationship between the Blocking Regulation and U.S. Sanctions.

The European Union's Blocking Regulation, which applies directly to the UK, is designed to counteract "long arm" U.S. legislation by prohibiting EU persons from complying with "any requirement or prohibition, including requests of foreign courts, based on or resulting, directly or indirectly" from the foreign laws specified in the Blocking Regulation's annex. This phrasing is deliberately broad and is likely to encompass all actions or measures taken by the U.S. entities responsible for enforcing sanctions. In essence, it seeks to criminalize (in the EU) efforts by persons in the EU to comply with certain U.S. sanctions that the EU finds objectionable. As such, the interaction of U.S. Sanction and the Blocking Regulation can put U.S. owned businesses in the EU in an invidious position.

The claimant had argued that, had the sanctions clause been otherwise applicable, then the EU Blocking Regulation would nevertheless compel the court to disapply it because the defendant's reliance on exclusion itself constituted "compliance" with ITRA in breach of article 5 of the Blocking Regulation (and therefore in breach of English criminal law).

The court indicated that it saw '"considerable force" in insurers' argument that the Blocking Regulation was not engaged where the insurer's liability to pay is suspended under a sanction clause such as the one in the policy. In such a case, the insurer is not "complying" with a third country's prohibition but is simply relying upon the terms of the policy to resist payment.

Conclusions and Comment

The main point to emerge from the case is the court's clarification that, for this standard Sanctions Exclusion clause to apply, it is not enough for the insurer to show that it "would be exposed" merely by dint of the possibility that an enforcing authority might conclude that payment of the claim would be a breach of sanctions. Rather, "the clause provides that the insurer is not liable to pay a claim where payment would be prohibited under one of the named systems of law and thus "would expose" the Defendant to a sanction."[4]

In practice, that means, where foreign sanctions are concerned, that the insurer will have to prove to the court, with expert evidence, what actual legal meaning and effect is of the foreign sanctions legislation so as to satisfy the English court that the transaction would be prohibited under that legal system. The court will hear expert evidence on questions of foreign law, but where they conflict, can make its own determination. (Where domestic UK sanctions are concerned, the court will not need to hear expert evidence on the point but will make its own determination following legal argument.)

Insurers faced with a transaction that may potentially be sanctioned will need therefore to undertake a detailed and thorough analysis of the U.S. / relevant sanctions law, before raising the exclusion, to be satisfied that sanctions, in fact, prohibit the transaction in question.

The court's finding that the sanctions exclusion clause in this case, which is a typical clause, is only suspensory is likely to have two consequences:

- Insureds concerned about the possibility of sanction preventing payment of a claim may consider it wise to issue proceedings promptly so as to prevent the limitation period expiring during the time that claim cannot be paid due to sanctions;
- Insurers may need to be prepared to hold reserves for many years, potentially even decades, for the period in which their ability to pay is suspended. Insurers concerned about such an issue may wish to consider using a different sanctions clause and/or perhaps a "long stop" contractual time bar clause that extinguishes their liability if, e.g., they are unable to pay the claim for a certain number of years.

The court's finding that the EU Blocking Regulation would not apply to this clause, in these circumstances, provides a welcome insight, however sanctions rules are complex, varied, and often subject to change, so each situation will need to be considered individually.

To discuss any questions you may have regarding the issues addressed in this Alert, or how they may apply to your particular circumstances, please contact Andrew Tobin at atobin@cozen.com or +44 (0)20 7864 2027 or Marli Wildschut at mwildschut@cozen.com or +44 (0)20 7864 2024.

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[1] [2018] EWHC 2643 (Comm), [2018] LLR IR Plus 48; Judgment 12 October 2018

[2] *Iranian Transaction and Sanctions Regulations*

[3] *Council Regulation (EU) No 267/2012*. NB After the UK leaves the European Union (Brexit) this regulation will be adopted as UK domestic law by operation of s.3 of the *European Union (Withdrawal) Act 2018*, and so will remain applicable in the UK unless and until parliament legislates to change it.

[4] Paragraph 50 of the judgment.