Sanctions and Their Effects on Contractual Obligations: From the Perspective of International Instruments and Iranian Law

by

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Abstract

According to the principles of pacta sunt servanda the contract should remain intact as far as possible. Nevertheless, it is highly likely that the parties might be unable to live up to their obligations on ground of occurrence of some unpredictable events. Traditionally, such phenomena may range from war, an earthquake, or a strike to tornadoes. Sanctions or embargoes are new instances of such phenomena that may make contract performance either impossible or extensively onerous. These sanctions involve different legal consequences besides economic, political and social effects. Nonetheless, it should be noted that the main subject of the present article is only confined to examine the effects of sanctions on contractual obligations from the perspective of significant international instruments like UPICC, PECL, the CISG and the Iranian national law. In this respect, we have focused on some important legal concepts like force majeure and hardship and their relationships with the imposition of sanctions. In so doing, after a brief overview of different kinds of sanctions from different perspectives, we have concentrated on correlation with the above institutional norms and its effects on contractual obligations. In the end, we address the available remedies arising out of sanctions impositions.

Key words

Sanctions, Effects, Contractual Obligations, International Instruments, the Iranian Law

1 Introduction

It is suggested that "sanctions" and "embargoes" refer to governmental and international actions that distort free flow of trade in goods, services, or ideas for decidedly adversarial and political rather than economic purposes. Over time, sanctions and embargoes have become a principal tool of foreign policy.[1] These sanctions and embargoes involve different legal consequences besides economic, political and social effects. However, the main subject matter of the present article is only confined to examine the effects of sanctions on contractual obligations from the perspective of Iranian national law and some other significant international instruments like UPICC[2], PECL[3] and the CISG[4]. It should also be noted that the subject of this article is not the contracts which have been prohibited by sanctions rather those contracts which their performance have turned out to be onerous or impossible as a result of sanctions. So, to carry out this comparative study, after a brief glance at the category of sanctions and embargoes and their different impacts, the subject of possibility of excusing the non-performing party due to sanctions and embargoes will be examined. To do this, we will focus on the subject from the view point of Iranian national law and said international instruments considering that these phenomena can influence both national and international contracts. It deserves noting that the reason behind addressing the Iranian civil code lies in the fact that Iran has been targeted by sanctions extensively in recent times and as a result, Iranian traders have difficulty doing business and living up to their contractual obligations. This requires us to examine the correlation between sanctions and some relevant legal concepts namely hardship and *force majeure*. Finally, we will address effects resulting from these phenomena.

2 General Overview of Sanctions and Embargoes and Their Different Impacts

In one classification and from the viewpoint of source of imposition, sanctions can be divided into three categories, that is, sanctions imposed by UN, by the EU and sanctions imposed by countries individually.[5] Furthermore and from the perspective of their purposes, sanctions can also be split into economic and political embargoes and sanctions that are imposed for the sake

[1] Michael R. Czinkota and Ilkka A. Ronkainen and Michael H. Moffett, Fundamentals of International Business, 76 (Wessex Pub 2d ed. 2009).

[2] UNIDROIT Principles of International Commercial Contracts

[3] Principle of European Contract Law

[4] United Nations Convention on Contracts for the International Sale of Goods

[5] Farshad Shamgholi, Sanctions against Iran and Their Effects on the Global Shipping Industry, 1-25 (Spring 2012), available at: http://lup.lub.lu.se/luur/download?func=downloadFile&recordOId=2520391&fileOId=3046709.

of safety and health.[6] These sanctions regardless of their types can affect different kinds of contracts. Some of them like bank sanctions and oil embargoes involve economic and legal effects that, among others, cause the inflation rate to rise and the obligor not to meet his contractual obligations. In some other cases, sanctions have to do with peoples moral and human rights. In these cases, non-performance of contract can lead to non-pecuniary damages.[7] Nonetheless, as mentioned above the main objective of the present article is to examine effects of imposition of sanctions and embargoes on contractual obligations under Iranian national law and the above-mentioned international instruments.

3 The Relationship between Sanction, *Force Majeure* and Hardship

3.1 Contract Law Starting Points

It is firmly acknowledged that the principle of *pacta sunt servanda* is a generally accepted principle in all legal systems. The contracts must stay intact as far as possible. This is because avoidance or termination of contract, among other things, can give rise to additional costs that are not acceptable from the standpoint of economic analysis. This is specifically the case in relation to international sales contracts since in most cases, goods are transferred from country to country, and the expenditures of restitution of goods can trigger unintended difficulties in the case of termination of the contract. Nevertheless, in some cases, unexpected changes in the circumstances come into existence that makes contract performance impossible, or excessively difficult. Examples of these events can be earthquakes, wars, floods, and hurricanes and the like. Sanctions and embargoes are among recent examples of such phenomena that may make contract performance, depended on circumstances, impossible or burdensome. For these reasons, all national legal systems have recognized some rules to deal with these kinds of problems. The two major legal concepts dealing with the problem of changed circumstances are those of *force majeure* and hardship. As a result, it is necessary to examine the effects of sanctions on contractual obligations having the two mentioned concepts in mind. This is

[6] Nico J Schrijver, the Use of Economic Sanctions by the U.N Security Council: An International Law Perspective, in Harry H.G. Post (ed), International Economic Law and Armed Conflict, 125 (Martinus Nijhoff Pub 1994).

[7] For examples of such effects see: Michéle Barry, Effect of the U.S. Embargo and Economic Decline on Health in Cuba, 151-153 (18 January 2000· Annals of Internal Medicine· Volume 132· Number 2), Karine Morin and Steven H. Miles, The Health Effects of Economic Sanctions and Embargoes: The Role of Health Professionals, 159-160 (18 January 2000· Annals of Internal Medicine· Volume 132).

because conditions and effects of two legal concepts are not the same.[8] However, since responses to the problem of change of circumstances differ considerably from one legal system to another this section of article has limited its scope to examine the Iranian civil law and some other important instruments like PECL, the CISG, and UPICC. Nevertheless, before delving into the position of the Iranian civil code and mentioned instruments it would be of help to give some perspective concerning these legal concepts to have a better understanding of effects of sanctions on contractual obligations.

3.2 Definitions of *Force Majeure* and Hardship

There is no authoritative definition for the concept of *force majeure*. The approach of national legislation with respect to *force majeure* varies considerably from country to country.[9] Nevertheless, the term may be used as a general term referring to some kind of events that serve as a basis for an exemption from liability; therefore, certain general characteristics of the concept of *force majeure* can be determined. These conditions are where (i) the event is of an external nature, (ii) it could not be foreseen or prevented and (iii) it renders performance of a contractual obligation impossible at all or for a certain time.[10]

The concept of hardship also does not exist in all legal systems, and even, in those systems in which the concept has taken roots, its conditions and effects are not the same, so coming up with a comprehensive definition of hardship is a very difficult task. [11] Nevertheless, reference to international instruments like UPICC can give us much more harmonized and unified definition. UPICC rules on hardship are stated in Arts 6.2.1-6.2.3. According to Art 6.2.2

[8] In fact, hardship is at stake where the performance of the disadvantaged party has become much more burdensome, but not impossible, while *force majeure* means that the performance of the party concerned has become impossible, at least temporarily. Moreover, there seems to be a functional difference between the two concepts. Hardship constitutes a reason for a change in the contractual program of the parties. The aim of the parties remains to implement the contract. *Force majeure*, however, is situated in the context of non-performance, and deals with the suspension or termination of the contract. (Joern Rimke, Force majeure and hardship: Application in International Trade Practice with Specific Regard to The CISG and The UNIDROIT Principles of International Commercial Contracts, 202 (Kluwer 1999-2000). In fact, the effects of applying of hardship are less drastic. Rather than immediate exemption from damages and then possible termination, for example, Article 6.2.3 of UNIDROIT principles allows the affected party first to request negotiations and then to obtain either termination or adjustment of contract (Luke Nottage (2007), Changing Contract Lenses: Unexpected Supervening Events in English, New Zealand, U.S., Japanese, and International Sales Law and Practice, 405 (Indiana Journal of Global Legal Studies: Vol. 14: Iss. 2, Article 9), Available at: http://www.repository.law.indiana.edu/ijgls/vol14/iss2/9).

[9] Liu Chengwei, 'Remedies for Non-performance -Perspectives from CISG, UNIDROIT Principles and PECL' 246, available at: www.jus.uio.no/sisu/.

[10] Id.

[11]The various national laws solve in very different ways the problem of changes of circumstances which make the obligation of one party much more onerous but which do not amount to *force majeure*. Some accept it as basis for modifying the contract, others do not. (Ole Lando and Hugh Beale (ed), Principles of European contract Law, Parts I and II, 327, (Kluwer Law International, 2000).

where the occurrence of events fundamentally alters the equilibrium of the contract either because the cost of parties' performance has increased or because the value of performance a party receives has diminished and subject to subparagraphs A to D the hardship comes to existence.[12]

After a brief review of two critical concepts, it is time to examine the effect of sanctions under the Iranian legal system and the above-mentioned instruments. This will be done by giving two simple hypothetical examples and, of course having the two mentioned concepts namely, *force* majeure and hardship in mind as follows:

In the first illustration, an Iranian seller and a Swiss company entered into a contract for delivery of certain quantity of oil to the latter. After the conclusion of the contract, the authorities of United Nations put a temporary sanction against Iran banning any import from it. Therefore, the seller encountered difficulty handing over of the goods to the buyer. If we suppose that the seller is able to supply the goods from a neighboring country and with the same conditions that meet the requirements of the contract but it costs him too much and fundamentally alter the equilibrium of the contract what will the situation of the contract be like?

In the second illustration, the same parties with the same subject and conditions conclude a contract. Nevertheless, after the conclusion of the contract, the seller faces a permanent sanction that makes it impossible for him to meet his contractual obligation. Again, the question is what will the situation of the contract be like?

In response to the above-mentioned hypotheses, we can probe the subject matter from the standpoint of Iranian national law and international instruments. In so doing, after giving some general perspective of conditions of occurrence of *force majeure* and hardship, the situation of contract will be examined under discussed laws.

3.3 *Force Majeure* Requirements

In the context of the CISG, Article 79 sets out circumstances in which the non-performing party is excused from liability to pay damages. According to that Art "A party is not liable for a failure to perform any of its obligations if he proves that the failure was due to an impediment beyond his control and that he could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences".

[12] See also Article 6.111 of PECL and 1-110 of DCFR. In these Articles, in Spite of the Fact, that the Title of Articles are not Hardship but Their Contents and Comments Refer to this concept.

As it is self-explanatory, article 79 does not refer to *force majeure* and hardship or other similar concepts that exist in national legislations. This article is described as a limitation to the system of strict liability for damages that the CISG sets up in Art. 45, 74 etc.[13] As follows from the context of the article, three conditions are to be met in order to excuse the non-performing party from the liability to pay damages. Firstly, the defaulting party must prove that the non-performance was due to an impediment beyond his control. Secondly, he must prove that it could not reasonably be expected from him to have taken the impediment into account at the time of conclusion of the contract (i.e. Unforeseeability). Finally, he could not have avoided or overcome it or its consequences (i.e. Unavoidability).[14] From such a wording, some authors have pointed out that the article reflects the concept of *force majeure*.[15]

With respect to the impediments, it is generally suggested that the debtor's sphere of control is wide. In fact, there will rarely be impediments such as natural disasters (hurricanes, earthquakes, diseases etc.), effects of war or terrorist attacks which are beyond his control.[16] It should be kept in mind that these events *per se* do not constitute an impediment beyond the control of the obligor. But it must be determined by taking the circumstances of any particular case into account separately.[17] In short, it can be argued that what makes performance of contract objectively impossible can be regarded as an impediment but enumerating a comprehensive list of events that can make performance of contractual obligation impossible is both impractical and unreasonable.[18]

The second condition under Art.79(1) is that the promisor could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract. This does not necessarily mean that the provision can only apply to impediments that arise after the conclusion of the contract. It may be the case that the impediment already existed at that time but it was not recognizable to the debtor.[19]

Finally, under the third yardstick the impediment and its consequences must be of a kind that the debtor cannot avoid or overcome it. According to the Tallon "to avoid" means taking all

[13] Peter Huber and Alastair Mullis, The CISG A New Textbook for Students and Practitioners, 258 (Sellier 2007).

[14] Dionysios P. Flambouras, the Doctrines of Impossibility of Performance and Clausula rebus sic stantibus in the 1980 Vienna Convention on Contracts for the International Sales of Goods and the Principles of European Contract Law: A Comparative Analysis, 236, available at: http://www.Cisg.law.pace.edu/Cisg/biblio/Flabouras1.html.

[15] Denis Tallon, in Bianca-Bonell Commentary on the International Sales Law, 575 (Giuffrè, Milan, 1987), available at: http://www.cisg.law.pace.edu/cisg/biblio/tallon-bb79.html

[16] Peter Huber and Alastair Mullis, op.cit., at 259.

[17] Dionysios P. Flambouras, op.cit., at 267.

[18] Niklas Lindström, Changed Circumstances and Hardship in the International Sale of Goods, available at: http://www.Cisg.law.Pace.edu/Cisg/biblio/Lindstrom.html.

[19] Peter Huber and Alastair Mullis, op.cit., at 262.

the necessary steps to prevent the occurrence of the impediment and "To overcome" means to take the necessary steps to preclude the consequences of the impediment.[20]

The same rules in the UNIDROIT principles of international commercial contracts are stated in paragraph 1 of Art.7-1-7[21]. Except for minor differences in syntax, where the most noticeable difference being absence of a counterpart to CISG Art. 79(2),[22] Art. 7.1.7 reflects the same rules that does Article 79 of the CISG.[23]

According to paragraph 1 of Art. 7.1.7 "non-performance by a party is excused if that party proves that the non-performance was due to an impediment beyond its control and that it could not be reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences." In construing impediment in this provision, it has been stated that it does not necessarily have to be exogenous, i.e. external to the obligor's sphere of risk.[24]

As to the criterion of foreseeability of impediment it has been argued that the reason for that stems from the fact that if the obligor could have anticipated the risk of the event and its consequences, it would have, negotiated the contract differently, either by not assuming the obligation, or by inserting a *force majeure* or exemption clause in the contract. It could be thus said that foreseeability is merely availability at an early stage.[25] Furthermore, the possibility to avoid an impediment or to overcome it or its consequences must be interpreted narrowly. Accordingly, there would be a rare circumstance that amounts to *force majeure*. As a result, where the failure to perform the contract is due to promisors own behavior or where the judicial seizure of assets is the result of promisors own conduct, he would not be able to rely on *force majeure*.[26]

[20] Denis Tallon, op.cit., at 58.

[21] According to that article: Non-performance by a party is excused if that party proves that the non-performance was due to an impediment beyond its control and that it could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences.

[22] According to paragraph 2 of article 79 of the CISG: If the party's failure is due to the failure by a third person whom he has engaged to perform the whole or a part of the contract, that party is exempted from liability only if he is exempt under paragraph 1 and the person whom he has so engaged would be so exempt if the provisions of that paragraph were applied to him.

[23] Alejandro M. Garro, Exemption of Liability for Damages: Comparison between Provisions of the CISG (Art. 79) and the Counterpart Provisions of the UNIDROIT Principles (Art. 7.1.7), in J Felemegas (ed), An International Approach to the Interpretation of the United Nations Convention on Contracts for the International Sale of Goods (1980) as Uniform Sales Law, 237(Cambridge Univ. 2007).

[24] Jan Kleinheisterkamp, in Stefan Vogenauer and Jan Kleinheisterkamp (eds), Commentary on the UNIDROIT Principles of International Commercial Contracts (PICC),771 (Oxford University Press 2009).

[25] Id.

[26] Id. at 772.

Art 8:108 of PECL has the same wording with the Article 79 of the CISG and 7.1.7 UPICC. Comment C expressly states that the circumstances of the impediment are like those "traditionally required for force majeure".[27] The scope of application of Article 8:108 is defined by Comment A to the PECL, which states that "unlike the equivalent Article of CISG 79 Article 8:108 has to apply only in cases where an impediment prevents performance."[28] It can be inferred from this comment that PECL presupposes that impediments in Art. 79 encompass both circumstances in which performance is impossible and circumstances in which performing of contract is not impossible but involves onerous difficulty. Nevertheless, it should be kept in mind that the subject-matter is not so simple in the context of Art. 79 of the CISG and as it will be discussed later there is strong controversy among scholars about the ambit of impediment in the context of the CISG.

Under the Iranian civil code, rules on liability exemptions can be inferred from Art. 227[29] and 229[30] of the Iranian Civil Code (CC). According these articles, three conditions are to be satisfied in order to excuse the non-performing party from liability. These conditions are externality, irresistibility and unavoidability of supervening event.[31] Nevertheless, the unforeseeability requirement cannot be derived from these articles directly. However, Katouzian argues that this requirement is contained within the requirement of unavoidability.[32] As a result, as far as it is concerned with *force majeure* requirements it can be argued that the Iranian Civil Code is consistent with international instruments.

3.4 Hardship Requirements

As mentioned above the term hardship and *force majeure* are not mentioned in Article 79 of the CISG. As a result, the issue whether hardship falls within Article 79 ambit is a highly controversial subject among scholars and in jurisprudence.

[27] Ole Lando and Hugh Beale (eds), op.cit., at 327.

[28] Id.

[29] Art. 227of Iranian CC:"The party in breach is to pay damages only where it cannot prove that the non-performance was on the grounds of an extraneous event".

[30] Art. 229 of Iranian CC: "If the obligor cannot live up to its obligations as a result of occurrence of an event which is out of its control it will not be liable to pay damages".

[31] Nasser Katouzian, Iranian Civil Law: General principles of Contracts, Volume IV, 202 (Tehran, Enteshar pub 4th ed 2004).

[32] Nasser Katouzian, op.cit., p. 218.

According to some commentators and case law, the scope of impediments under the CISG has been confined to cases where contract performance becomes impossible.[33] In line with this group of writers, Flambouras have pronounced that the drafting history of the Convention is a legitimate and valuable aid in the interpretation of the Convention's provisions. It reveals that Article 79 of the CISG is indeed a stricter version of its predecessor, Article 74 ULIS, which had been criticized for excusing non-performance too readily, such as where performance merely became more difficult. As a result, the concept of hardship does not fall within the scope of the CISG.[34]

Nevertheless, it seems that recent literature and case law show high tendency toward including hardship situations under Art. 79 of the CISG and therefore it is suggested that hardship situations be dealt with under the CISG itself.[35]To support this view, Huber argues that if Arts. 79(1) and (5) of the CISG be interpreted alongside each other, it becomes clear that hardship falls within the scope of the CISG. In his opinion, it goes without saying that in cases in which *force majeure* occurs, demand of specific performance is unreasonable. However, it seems that the CISG, by setting forth 79(5) wanted to cover situations in which the performance of contract is still possible, but involves considerable difficulty.[36] To come up with a solution to the effect of hardship under the CISG, Schlechtriem has pointed out that Article 50 of the CISG is a basis for adjustment of the contract as a main effect of hardship.[37] In this connection, one court has held that the legal consequences of economic hardship include an obligation by the parties to renegotiate the contract.[38]

[33] Sarah Howard Jenkins, Exemption for Nonperformance: UCC, CISG, UNIDROIT Principles - A Comparative Assessment, 2025, Tulane Law Review (1998), available at: http://www.cisg.law.pace.edu/cisg/biblio/jenkins.html; Jennifer M. Bund, Force Majeure Clauses: Drafting Advice for the CISG Practitioner, 387 (17 Journal of Law and Commerce 1998), available online at: http://www.cisg.law.pace.edu/cisg/biblio/bund.html; Nuova Fucinati, S.p.A. v. Fondmetal International A.B. , Tribunale Civile di Monza (Italy), 14.01.1993, available at: http://www.unilex.info/case.cfm?id=21 (111).

[34] Dionysios Flambouras, Exemption and Hardship: Remarks on the Manner in Which the Principles of European Contract Law (Articles 6:111 and 8:108) may be Used to Interpret or Supplement CISG Article 79, in John Felemegas (ed), An International Approach to the Interpretation of the United Nations Convention on Contracts for the International Sale of Goods (1980) as Uniform Sales Law, 501 (Cambridge Univ. 2007).

[35] Peter J. Mazzacano, Force Majeure, Impossibility, Frustration & the Like: Excuses for Non-Performance; the Historical Origins and Development of an Autonomous Commercial Norm in the CISG, (Nordic Journal of Commercial Law issue 2011#2), p.48; Ingeborg Schwenzer, Force Majeure and Hardship in International Sales Contracts, (Victoria University of Wellington Law Review April 2009), p.713; Niklas Lindström, Changed Circumstances and Hardship in the International Sale of Goods, (Nordic Journal of Commercial Law 2006), also available at http://www.cisg.law.pace.edu/cisg/biblio/lindstrom.html#iv.

[36] Peter Huber and Alastair Mullis, op.cit., at 193,196.

[37] Peter Schlechtriem, in Harry M. Flechtner (ed), Transcript of a Workshop on the Sales Convention: Leading CISG Scholars Discuss Contract Formation, Validity, Excuse for Hardship, Avoidance, Nachfrist, Contract Interpretation, Parol Evidence, Analogical Application, and much more, 22 (18 Journal of Law & Commerce 1999), available online at: http://cisgw3.law.pace.edu/cisg/biblio/workshop-79.html.

[38] UNCITRAL Digest of Case Law on the United Nations Convention on Contracts for the International Sale of Goods, United Nations Commission on International Trade Law, 388 (2012 Edition).

In contrast to the CISG, UPICC has set forth separate provisions on hardship. Rules on hardship in UPICC are stated in Arta 6.2.2-6.2.3. Article 6.2.1[39] establishes the starting point for any analysis of the hardship provisions of UPICC. Art 6.2.2[40] defines hardship as a situation where the occurrences of events fundamentally alter the equilibrium of the contracts, provided that, those events meet the requirements which are laid down in subparagraphs (a) to (d).[41]Art 6.2.3 concerns the consequences of occurrence of hardship that will be examined in detail later in this article.

Provisions on hardship in the PECL have been stated in Art. 6:111. In spite of the fact that PECL employs the terminology «change of circumstance» rather than «hardship» in the context of the mentioned provision, it is evident when one looks at the conditions and effects of change of circumstances that Art. 6:111 reflects the concept of hardship. This is acknowledged when one looks at the Draft Common Frame of Reference (DCFR), which is an advanced version of PECL.[42]

The Iranian Civil Code has not set out a specific provision to deal with hardship situations. Nevertheless, Article 167 of Iranian Constitution requires judges to make use of "Islamic sources and Fatwas"[43] in matters where the Iranian codes are silent. In so doing, some authors[44] by relying on the *osro-o-haraj* –rule (the OSR rule) in sharia have pointed out that the concept of hardship can find its way into our legal system. The OSR rule literally means onerous difficulty and from legal points of view it implies situations where contract performance becomes considerably difficult. In this case the obligor will be granted some rights like extension of time for performance or will be exonerated from obligation. It should, however, be noted that unlike the hardship institution, the scope of the OSR rule is not confined to economic difficulty.[45] In relation to the consequences of hardship in Iranian civil code, there are controversies among scholars that will be discussed under relevant titles.

[39] According to Art 6.2.1 Where the Performance of a Contract Becomes More Onerous for one of the Parties that Party is Nevertheless Bound to Perform Its Obligation Subject to Provision on Hardship.

[40] According to Art 6.2.2 there is Hardship Where the Occurrence of Events Fundamentally Alters the Equilibrium of the Contract either because the Cost of Party's Performance has increased or because the Value of Performance a Party Receives Has Diminished.

[41] Art. 6.2.2 UNIDRIOT Principles 2010, official Cmt 1.

[42] Where the official comments to art 1:101 of DCFR state that: Exceptional hardship, under this Article, gives the court the choice of revising the terms regulating the obligation or terminating it altogether.(in Christian von Bar and Eric Clive (eds), Principles, Definitions and Model Rules of European Private Law, Draft Common Frame of Reference (DCFR), Prepared by the Study Group on a European Civil Code and the Research Group on EC Private Law (Acquis Group),Vol.2 (Sellier 2009), Official Cmt A.

[43] Fatwa is a legal opinion or ruling issued by an Islamic scholar.

[44] Mostafa Mohaghegh Damad, Qawa'ed-e-Figh, Maxims of Figh, 110 (Samt pub 2000).

[45] Ebrahim Shoarian and Ebrahim Torabi, Principles of European Contract Law and Iranian Law, A Comparative Study, 259 (Forouzesh pub 2010).

4 Determination Criteria

The concept of hardship and *force majeure* and their elements has been made clear, to some extent, under the discussed laws. In this section, we will examine conditions in which sanctions can be regarded as hardship or *force majeure* under the same laws. With respect to conditions in which sanctions may amount to hardship, however, it should be noted that we will focus on UNIDROIT principles given that the Iranian civil code and the CISG have not set forth clear-cut yardsticks to distinguish the two concepts.

According to the paragraph A of Article 6.2.2 UPICC, sanctions must occur or become known to the affected party after the conclusion of the contract. As a result, if sanctions come into existence before the conclusion of the contract on condition that the effected party is aware of their existence, he will not be able to resort to them. On the other hand, if it is unreasonable to expect the obligor to take the sanctions into account at the time of the conclusion of the contract he will be able to rely on sanctions. It should, of course, be noted that where the imposition of sanctions on specific countries is a commonplace phenomenon the disadvantaged party will hardly be able to invoke hardship since it is often possible to anticipate the occurrence of sanctions and its effects.[47] If at the time of the conclusion of the contract, sanctions were already in force, it is assumed that contracting parties has made the contract by assuming its risks. As a result, they will not be able to invoke sanctions to release themselves from liability. The situation will be different, however, where the subject-matter of the contract itself is targeted by the sanctions. In such a case, as it is confirmed by the national law of some countries like Swiss, French, English and American law, the contract will be void and unenforceable on the grounds of violation of public policy.[48]

In addition, the sanction must be beyond the control of the disadvantaged party to qualify as hardship.[49] By taking the origin of the sanction into consideration, this condition with respect to sanctions is usually met. This is because, sanctions are exterior to the defaulting party's activity and its behavior has, except where the disadvantaged party is a governmental organization, nothing to do with its occurrence. It should, of course, be noted that satisfaction of this condition in itself does not release the defaulting party from liability. This is because of the uncontrollable character of the sanction should be judged not only by taking into account of its origin but also having regard to the defaulting party's ability to avoid or overcome it. Therefore, if the obligor is able to avoid the sanction or overcome it he will not be able to

[46] Ewan McKendrick, in Stefen Vogenauer and Jan Kleinheisterkamp (eds), Commentary on the UNIDROIT Principles of International Commercial Contracts (PICC), 721 (Oxford Univ. 2009).

[47] Elliott Geisinger, Philippe Bartsch, Julie Raneda and Solomon Ebere, The Impact of International Trade Sanctions on Contractual Obligations on International Commercial Arbitration, 405-437 (I.B.L.J. 2012).

[48] Art 6.2.2(c) of UPICC.

invoke the liability exemption.[50] Finally, the affected party can only rely on the exemption when he has not already assumed the risk of sanctions.[51]

In sum, it must be said that in order for sanctions to qualify as hardship, its permanent or temporary feature does not play a decisive role and, therefore, regards should be paid to all relevant circumstances of any particular case.

As to the *force majeure*, it has been made clear that apart from some differences in syntax, all mentioned instruments and the Iranian Civil Code require the same criteria that can summarized in three conditions. Firstly, the sanction must be beyond the obligor's control. Secondly, it could not reasonably be expected from the obligor to have taken the sanction into account at the time of the conclusion of the contract. Thirdly, it was not possible for him to avoid the sanction or overcome it or its consequences.

With respect to the first criterion, it is necessary to note that sanctions are often to be regarded as an impediment beyond the control of obligor since his/her will plays no role in the occurrence of sanctions. But, the situation of issue may change where the contracting parties or at least one of them is a governmental organization. In this situation, given the fact that sanctions are imposed mostly on grounds of government actions, it will be difficult for the affected party to claim that the imposition of sanctions was beyond its control.

With regard to the second criterion, as we mentioned in examining hardship, if imposition of a sanction against a specific part of the world is a usual event, it seems that the obligor is rarely unable to take an impediment into consideration at the time of conclusion of the contract.

In relation to third criterion, we must admit that since in most cases the imposition of sanction does not have anything to do with obligor's will, he will often be unable to avoid a sanction or overcome it. But with respect to the consequences of a sanction, it might be argued that if the seller is able to supply the goods from other places or if the buyer is able to pay the contract price from other usual means of payment, the obligor would be unable to invoke a sanction as *force majeure*. But it ought to be born in mind that, if performance of the contractual obligation costs too much and makes the performance extremely onerous for him, the situation may constitute hardship. In any event, in determining the situation of sanctions all relevant circumstances must be considered and it is impossible to treat sanctions as hardship or *force majeure* as such.

In a case involving a Swiss national embargo on export of certain types of machinery that could potentially be used in the production of nuclear weapons, the Swiss Federal Supreme Court ruled that the enactment of embargo qualified as a supervening legal impossibility within the meaning of Article 119 CO. The Supreme Court specified, however, that the seller of such

[50] Denis Tallon, op.cit., at 579.

[50] Art 6.2.2(d) of UPICC.

goods may still be held liable for any damages resulting from non-performance, if he knew or could have known about the future embargo at the time the contract was made.

In this case although the court accepted the fact that the enactment of embargo qualified as a supervening legal impossibility it rejected to release the obligor from liability. This reflects the idea that the external character of a sanction does not in itself make the event beyond the promisor's control but it should also be unforeseeable and unavoidable.

5 Breach of Contract Caused by Sanction and its Effects

5.1 Damage Claims

As mentioned above, imposition of a sanction may make contract performance either impossible or excessively difficult. In the first case, the breach of contract is definite but in the latter, this is not the case, at least, immediately. Therefore, effects and remedies resulting from such events must be examined for *force majeure* and hardship separately.

In cases where the sanctions qualify as *force majeure*, according to all above-mentioned instruments, the affected party will be excused from liability to pay damages.[52] It should, however, be noted that where the sanction is only temporary, the excuse has effect for the period during which the sanction is in force.[53] This is also the case under the Iranian Civil Code. According to Article 227 of Iranian CC: «The party in breach is to pay damages only where it cannot prove that the non-performance was on the grounds of an extraneous event». In addition Article 229 of Iranian CC sets forth: »If the obligor cannot live up to its obligations as a result of occurrence of an event which is out of its control it will not be liable to pay damages.»

However, with respect to the hardship, the subject-matter of exoneration from paying damages may seem confusing at first glance. This is because in the case of hardship there is no breach of contract on the side of disadvantaged party. So the question is raised whether recovery of damages and subsequently exoneration from paying damages come into play or not. In response, it should be noted that the exemption from liability of paying damages is not relevant in this situation. This is because the time of performance of the contract has not yet been expired. As a result there is no breach of contract on behalf of the disadvantaged party. For this

[51] Art79(5) of CISG; Comment D on Art 8:108 to PECL(in Ole Lando and H Beale, op.cit., at 379); 7.1.7(1), in Jan Kleinheisterkamp, in Stefan Vogenauer and Jan Kleinheisterkamp (eds), op.cit., at 775.

[52] Art79(3) of CISG, 8:108(2) of PECL,7.1.7(2) of UPICC

reason, UPICC has dealt with hardship in the chapter on performance. On the other hand, rules on *force majeure* have been dealt in the chapter on non-performance.[54]

Accordingly, the hardship does not present the matter of breach of contract and the aggrieved party cannot recover damages on grounds of hardship, rather, to safeguard the affected party because of changed circumstances, the legislator has enabled the disadvantaged party to ask other party to renegotiate the conditions of contract. In fact, in these situations the consequences of burden is dealt with as an aspect of performance.[55]

Nevertheless, this result may be disputed if one take notice of Article 6:111(3)(c) of PECL. In studying the rules of PECL in Art 6:111(2)(c) the court may award damages for the loss suffered through a party refusing to negotiate or breaking off negotiations contrary to good faith and fair dealing. But it should be said that awarding to such damages is not on account of hardship rather it results from breach of obligation to observe good faith. In this regard, official comment states that the obligation to renegotiate is independent and carries its own sanction. The compensation provided by Article 6:111(3)(c) of PECL will normally consist of damages for the harm caused by refusal to negotiate or breaking of negotiation in bad faith.[56]

5.2 Termination or Avoidance of the Contract

Regardless of the fact that sanctions make contract performance impossible or burdensome the question is raised whether the aggrieved party will be able to put an end to the life of contract or not. To answer the question we must examine the situation of sanctions in two different assumptions namely where they constitute *force majeure* and where they amount to hardship.

In the framework of the CISG answering this question calls for close attention to Art 79(5) which reads: "Nothing in this article prevents either party from exercising any right other than to claim damages under this convention." In short, the aggrieved party's right to avoid the contract is not affected by Article 79.[57]

Like CISG, official comments on PECL with regard to Art. 8:108 has pointed out that the aggrieved party may put an end to the contract by a unilateral declaration provided that the non-performance is fundamental. It follows that in principle it will be for the creditor to

[53] Joseph M. Perillo, Force Majeure and Hardship under the UNIDROIT Principles of International Commercial Contracts, 120, available at: http://www.cisg.law.pace.edu/cisg/biblio/perillo3.html

[54] Liu Chengwei, op.cit., at 330.

[55] Ole Lando and H Beale, op.cit., at 326.

[56] John Honnold, Uniform Law for International Sales under the 1980 United Nations Convention, 490 (3rd ed. 1999), for An Opposite View See: Denis Tallon, op.cit., at 589 (where he state: Specific performance is, by definition, impossible and avoidance useless).

exercise this right by giving notice of termination to the debtor under Article 9:303.[58] As a result, according to this instrument as well, regardless of the exemption of obligor on ground of sanction, the obligee will be able to terminate the contract.

In UPICC also, if non-performance is excused, the obligor is only protected against obligee's claim for damages resulting from non-performance. As explicitly pointed out in Art. 7.1.7(4), *force majeure* does not prevent the obligee from exercising a right to terminate the contract under the conditions of Art 7.3.1. With the termination of the contract, all losses directly caused by the sanction (*force majeure*) are eventually born by the obligor.[59]

Under the Iranian Civil Code in the event of occurrence of sanction that qualifies as *force majeure* the contract is automatically extinguished and the obligor, therefore, released from liability.[60]

However, the question whether the obligee may terminate the contract where an imposed sanction qualifies as hardship will be a different issue. This stems from the fact that effects of hardship differs from the effects of *force majeure*. The following will address the effects of sanctions, when it qualifies as hardship under discussed laws. However, given the fact that there are no specific rules to deal with the issue in the CISG we have not covered the CISG in this section.

The UNIDROIT principles in Article 6.3.3 allow, in the case of hardship, the disadvantaged party to request renegotiations. However, the request for renegotiation does not entitle the affected party to withhold performance. If the parties cannot agree on an adjustment of contract within a "reasonable" time, either party may resort to a court. Then it is up to the court to either terminate the contract at a date and on terms to be fixed, or adapt the contract with a view to restoring its equilibrium.[61] It should be noted that «termination» in this Article is not the same as termination which takes place in the event of non-performance. The court has discretion with respect to the time and the terms of termination, which it does not have in the case of termination for non-performance.[62] As a result it can be inferred, that in cases which a sanction amounts to hardship, the aggrieved party has no discretion to terminate the contract unless the time for performance expires. Art 6:111 of PECL includes the same rule as UPICC.

[57] Ole Lando and H Beale, op.cit., at 381.

[58] Jan Kleinheisterkamp, in Stefan Vogenauer and Jan Kleinheisterkamp (eds), op.cit.,, at 775.

[60] Ebrahim Shoarian and Ebrahim Torabi, op.cit., at 308.

[60] Frederick R. Fucci, Hardship and Changed Circumstances as Grounds for Adjustment or Non-Performance of Contracts Practical Considerations in International Infrastructure Investment and Finance, available at: http://www.cisg.law.pace.edu/cisg/biblio/fucci.html; Abd al-Razzaq Ahmad al-Sanhuri, Masader al-haq in Islamic Jurisprudence, Vol. 6, 90 (Halabi Law Books pub, 2d ed, 1998).

[61] Ewan Mckendrick, in Stefan Vogenauer and Jan Kleinheisterkamp (eds), op.cit., at 724.

When it comes to the Iranian Civil Code there is no agreement among scholars as to the possibility of termination of contract because of hardship. This derives from the fact that the Iranian Civil Code has not set out special rules to deal with hardship situations. Nevertheless, according to some Shari'a commentators, if the hardship causes the obligee to sustain unreasonable loss, he will be able to terminate the contract. Some other commentators are of the opinion that in such cases the contract will be terminated automatically.[63]

5.3 Modification of the Contract

The possibility of modification of the contract in the event of imposition of a sanction is another remedy that needs to be examined. In this regard, it is necessary to distinguish between the situation in which a sanction makes contract performance impossible and the situation in which contract performance becomes burdensome as result of a sanction.

In situations where a sanction makes contract performance extremely difficult, both PECL and UPICC recognize the possibility of contract modification. In fact, the primary effect of hardship is the contract modification that is made by affected party's request from the other side of contract.[64] Nevertheless, the request should be made without undue delay and should indicate the grounds on which it is based.[65] In cases where the parties stipulate the possibility and methods of modification, these bind them. If the parties fail to reach an agreement, either party may resort to the court.

However, in cases where the contract is silent about the possibility and method of modification, it does not mean that the affected party cannot request modification of the contract. In these situations, modification is made by asking the other party to renegotiate the condition of contract. If the court finds hardship, it may terminate the contract at a date and on terms to be fixed, or adapt the contract with a view to restoring its equilibrium.[66] But it should be noted that the court's decision to terminate or to modify the contract is very much a last resort. The whole procedure is devised to encourage the parties to reach an amicable settlement; hence the obligation to enter negotiations.[67] However, if the court decides to modify the contract, it may

[62] Islamic Encyclopedia (In Arabic), Vol. 30, 31 (Kuwait Minister of Religious Endowment and Islamic Affairs, 2d ed, 1983); Alireza Yazdanian, Adjustment of Contractual Obligations on the Base of Islamic Law, 129,131,(Journal of Magalat wa Barrasiha, Vol.39, No.82, 2006), available at: http://www.noormags.com/view/fa/articlepage/486455.

[63] 6:111(2)of PECL; 6.2.3(1)UPICC.

[64] 6.2.3(1)UPICC.

[65] PECL Art. 6:111(3)(a)(b)]; UPICC Art. 6.2.3(4)(a)(b).

[66] Ole Lando and H Beale, op.cit., at 324.

be done through extending time of performance, increasing or reducing the price or the contract quantity or ordering a compensatory payment.[68]

The Iranian Civil Code is silent with respect to the effects of hardship and accordingly the possibility of contract modification where sanction makes contract performance burdensome. However, the appropriate view seems to be one of considering the modification of contract as a suitable method of dealing with the effect of hardship. In addition, some Islamic commentators have confirmed the possibility of modification of the contract in the case of a change of circumstances.[69]

As far as the possibility of contract modification in cases of *force majeure* is concerned, it ought to be said that where sanction makes contract performance impossible the possibility of contract modification ought to be ignored. Therefore, in these situations given that performance of contract is impossible it is not practical to modify it.

5.4 Suspension of Performance

With regard to the remedy of suspension of performance, it is also important to distinguish between situations where the imposed sanctions make contract performance impossible and where they make it unduly burdensome.

As to the *force majeure* situation, the CISG and PECL are silent. However, as far as the CISG is concernedit has been held that the performance claim is suspended. Although Arts.46 and 62 do not include any express statement regarding this, the idea lying behind Art. 79(3) can be applied by analogy.[70]

Unlike the CISG and PECL, UPICC has dealt expressly with the issue. Article 7.1.7(4) reads, "nothing in this article prevents a party from exercising a right to terminate the contract or to withhold performance or request interest on money due". As a result, the obligee may withhold its performance in accordance with Art. 7.1.3 until the *force majeure* situation comes to an end under Art. 7.1.7(2) or until the delay eventually amounts to a fundamental breach. [71] Nonetheless, where the imposed sanction is permanent; performance suspension will not be relevant at all. Since, in such case, the non-performance will amount to a fundamental breach and the aggrieved party will be able to terminate the contract.

[67] Id.

[69] Alireza Yazdanian, op.cit., at 131.

[70] Yeşim M. Atamer, Availability of Remedies other than Damages in Case of Exemption According to Art. 79 CISG, in A Büchler M Müller-Chen(ed), Private Law national – global – comparative, 98 (Festschrift für Ingeborg Schwenzer, Stämpfli Verlag/Intersentia 2011).

[70]Jan Kleinheisterkamp, in Stefan Vogenauer and Jan Kleinheisterkamp(eds), op.cit., at 775.

The Iranian Civil Code is also silent in this regard. Nonetheless, some commentators have pointed out that if *force majeure* is only temporary, the performance of contractual obligations will be suspended until the impediment ceases.[72]

However, when it comes to hardship situations, the probability of suspension of performance can be examined from two standpoints having regard to the fact that who is the claimant.

Where the claimant of performance suspension is the obligee it will not be relevant at all. This stems from the fact that on the one hand, the due date of performance has not expired and on the other hand, the obligor may still want to perform his obligations. To put it differently, given that the obligor has not committed any breach, the obligee cannot withhold its performance unless the parties are to perform their obligations simultaneously that in this case the obligee may be able to withhold its performance.[73]

However, when it comes to the obligor it may be argued that given the effects of hardship, the obligor will be able to withhold its obligation until the contract is adopted to new circumstances. But, according to Art. 6.2.3(2) of UPICC the request for negotiation does not in itself entitle the disadvantaged party (obligor) to withhold its performance. In interpreting the provision , it has been pointed out that the words "in itself" have a great significance. The entitlement of affected party to suspend performance does not follow from the impact of events that have created the hardship. Nevertheless, where the consequences of event are sufficiently extraordinary [74] the disadvantaged party may be entitled to withhold performance.[75]

5.5 Specific Performance

Where a sanction makes contract performance either impossible or burdensome another question raised is whether the other party can still insist on specific performance or not.

In cases where sanction makes contract performance impossible, the PECL exclude any form of specific performance.[76] However, in the framework of the CISG, even if the affected party is exempted from liability on account of *force majeure*, this does not impair other party's right to demand specific performance.[77] This position has been criticized by many commentators on the grounds that it involves unreasonable results.

[71] Nasser Katouzian, op.cit., at 201.

[72] Art.7.1.3 UPICC; Art.9:201 PECL.

[73] See illustration 4 to Art. 6.2.3 UPICC.

[74] Ewan Mckendrick, in Stefan Vogenauer and Jan Kleinheisterkamp (eds), op.cit., at 724.

[75] Ole Lando and H Beale, op.cit., at 381.

[76] Peter Huber and Alastair Mullis, op.cit., at 264.

In this respect, as some authors have stated, the UNIDROIT Principles seem to find a flexible answer to the question of what is to become of the right to performance.[78] The UNIDROIT Principles adhere to the principle that the excuse is general, but in Art. 7.1.7(4) they make important exceptions in determining certain claims which are not affected by *force majeure*, namely the right to terminate the contract or withhold delivery or request interest on money due. The official comment makes some of its dispositions clear: "In some cases the impediment will prevent any performance at all but in many others, it will simply delay performance and the effect of the article will be to give extra time for performance". It should be noted that in this event the extra time may be greater (or less) than the length of the interruption because the crucial question will be what the effect of the interruption on the progress of the contract is.[79] As a result, in the framework of UPICC the possibility of demanding specific performance in the case of exemption will depend on the circumstances of each particular case.

However, where sanction makes contract performance burdensome, the CISG has not set out special rule in relation to the possibility of demanding specific performance. On the other hand, Art.6.2.2 (2) of the UPICC has explicitly set out that the request of renegotiations cannot *per se* justify suspension of contract on behalf of the affected party. This means that the other party can still demand specific performance. But, as we mentioned above where the consequences of event are sufficiently extraordinary, the disadvantaged party may be entitled to withhold performance. Therefore, in this situation, the other party will be unable to demand specific performance at least for a period in which the event is in progress.

In spite of the fact that the Iranian Civil Code is silent with respect to the consequences of *force majeure*, some authors have pointed out that if *force majeure* is permanent (in our assumption the sanction), the obligation will be eliminated automatically and demanding of specific performance will be impossible. However, in cases where *force majeure* is temporary, the other party cannot demand specific performance in the period in which the sanction is in progress.[80]

The Iranian Civil Code has also laid down no rule on hardship situations but some Islamic commentators are of the opinion that in these situations onerous part of the obligation is eliminated. Nonetheless, the other part is still valid. In addition, according to *figh* rules hardship cannot give rise to the right to terminate the contract, rather, its effect is modification of contract.[81]

[77] Liu Chengwei, op.cit., at.326.

[78] Art 7.1.7(4)UNIDROIT Principles 2010, official Cmt 2.

[79] Nasser Katouzian, supra note 34; Mehdi Shahidi, Effects of Contracts and Obligations, 64 (Majd pub, 2d ed. 2004).

[80] Sharifi Elhamoddin, Safari Nahid, A Comparative Study on Effects OF Hardship in Principles of European Contract Law (PECL),UNIDROIT Principles of International Commercial Contracts and Iranian Law, Comparative Law Review, 20 (September 2010, Vol.5 Issue 2).

6 Conclusion

The present article was an attempt to address the effects of sanctions as new instances of excusing events on contractual obligations under the Iranian Civil Code and international instruments. In so doing, we examined the standards of exemption under both *force majeure* and hardship situation considering that sanctions might make contract performance either impossible or excessively burdensome.

As far as it is concerned to *force majeure* requirements, it can be said that all international instruments require the same. However, the Iranian Civil Code does not deal with the issue specifically. Nonetheless, the same rules can be derived from Articles 227 and 229 of the Iranian Civil Code.

When it comes to hardship situations, it has also been made clear that, except the CISG, UPICC and PECL has set out specific rules in this regard. Nevertheless, according to the majority of scholars, article 79 of the CISG ought to be read in a way that encompasses hardship situations as well. The Iranian Civil Code, again, has not set out special rule in this regard. However, its inclusion in the Iranian Civil Code is justified through *osro-o-haraj* rule.

But, as far as it is concerned to the effects of sanctions the following conclusions can be drawn with respect to the issue.

As for the damage claims, the study showed that the effects of a sanction will be different where it makes contract performance impossible (First Situation) and where it makes it excessively difficult (Second Situation). In the former case, under all discussed laws the defaulting party will be exempted from liability to pay damages. But in the latter case under both UPICC and PECL exemption from liability to pay damages will be irrelevant since hardship does not pose a breach of contract. The Iranian Civil Code and the CISG are silent in this regard.

With respect to avoidance or termination of contract, in the first situation all international instruments enable the aggrieved party to declare the contract avoided. On the other hand, under the Iranian Civil Code, the contract will be terminated *ipso facto* and there is no need for a declaration of avoidance. In the second situation, the possibility of termination of contract will be treated as a last resort remedy. In the Iranian legal system there is controversy among scholars. Some are of the opinion that the contract will be avoided automatically and some believe that the aggrieved party has an option to do this.

As to the remedy of modification of the contract, in the first situation both UPICC and PECL recognize modification as a main effect of hardship. Despite the CISG's silence in this regard this position is also verified under the CISG. In the second situation to speak of modification of contract will be irrelevant.

With respect to remedy of specific performance, in the first situation the PECL exclude it at all. The CISG when interpreted literally took quite the opposite position. However, under UPICC the possibility of demanding specific performance will depend on the circumstances of each

particular case. In the second situation, the possibility of specific performance will generally depend on the severity of sanction.