Civil Liability on the Periphery

Civil Liability on the Periphery: Third Country Transactions in Violation of United States Economic Sanctions

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Introduction

One of the most controversial foreign policy issues between the European Community and the United States concerns the extraterritorial application of US economic sactions against third country nationals who conduct commercial transactions involving states and other entities that are targeted by US sanctions. Indeed, the extraterritorial use of US sanctions has created important issues of third and fourth party liability for third country nationals who are parties to contracts that are collateral to transactions involving US-targeted states. The doctrinal bases for such peripheral liability can be found in the English common law rule against trading with the enemy and in the doctrine of foreign illegality.[1] The principal focus of this article will be on the origins and development of the English law rule against trading with the enemy and how its principles of peripheral liability for collateral contracts have been applied in recent English case law with respect to English law contracts that violate the extraterritorial provisions of foreign laws. In particular, important issues of civil liability and public policy arise regarding whether to enforce contractual obligations that may violate the laws of foreign and friendly states. These issues are crucial for determining whether extraterritorial economic sanctions *per se* can have any legal validity under the laws of third countries and consequently whether such sanctions have any effect in obstructing or blocking third country transactions with targeted entities. The effectiveness of extraterritorial sanctions will depend in part on whether third country courts are willing to abrogate or modify contractual obligations arising from transactions that violate the economic sanctions laws of a foreign state.

Indeed, the extraterritorial use of US sanctions has created important issues of third and fourth party liability for third country nationals who have entered commercial transactions with targeted states. This article discusses some of the important issues of civil liability under English law that arise as a result of the extraterritorial application of US economic sanctions. The doctrinal bases for such peripheral liability can be found in the English common law rule against trading with the enemy and in the doctrine of foreign illegality.[1] This article analyses how liability on the periphery may arise for third country nationals who enter contracts that are legal under the laws of their home countries but are, or become, illegal under the economic sanctions laws of foreign countries. Important issues of liability and public policy arise regarding the enforcement of contractual obligations that may violate the laws of a foreign and friendly state. These issues are crucial for determining whether extraterritorial economic sanctions per se can have any legal validity under the laws of third countries and consequently whether such sanctions have any effect in obstructing or blocking third country transactions with targeted entities. The effectiveness of extraterritorial sanctions will depend in part on whether third country courts are willing to abrogate or modify contractual obligations arising from transactions that violate the economic sanctions laws of a foreign state. The principal focus of this article will be on the English common law, and how the doctrine of foreign illegality has been interpreted by English courts in determining whether to enforce contracts that are illegal under foreign law.

In recent years, English courts have refused to enforce contracts governed by foreign law on the grounds of public policy because the contracts as such violated the export control laws of a foreign and friendly country.[2] More significantly, with respect to extraterritorial US economic sanctions, there is some authority for the proposition that English courts will refuse to enforce a contract governed by English law involving UK nationals if the parties intended the contract by its terms to violate the laws of a foreign, friendly state. The English Court of Appeal accepted this rule in the *Foster v Driscoll* case in 1929 and has expanded its application to cover financial instruments governed by English law but which violate the banking or securities laws of a foreign country.[3] This article contains three parts. Part I traces the development of the English common law rule against trading with the enemy and its statutory equivalent. This section demonstrates that the doctrinal foundation of the extraterritorial use of economic sanctions can be found in the common law rule against trading with the enemy and the British Trading with the Enemy statutes. Part II examines the doctrinal bases for abrogating or modifying contracts that are illegal or impossible to perform. Part III discusses the extent to which illegality under foreign law renders contracts unenforceable and how this doctrine may be applied in the context of extraterritorial US economic sanctions.

I. Common Law Antecedents

A. Trading with the Enemy at Common Law

The legal origins of the use of economic sanctions to restrict commercial activity with targeted states and their nationals can be found in the English common

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law. Indeed, an important principle on which the use of economic sanctions has been based is the doctrine of non-intercourse, which restricts commercial interaction between the residents of belligerent states.[4] This doctrine has been given broad application under English law insofar as it prohibits all intercourse with the enemy state and its nationals which might result in detriment to the sanctioning state or in advantage to the enemy, regardless of whether the intercourse is commercial. Accordingly, all contracts involving intercourse with the enemy are abrogated on the outbreak of war. The basis of the doctrine was originally set forth by Lord Stowell in *The Cosmopolite* in 1801 when he stated that there shall be 'no intercourse between the subjects of hostile states.'[5] This absolute prohibition between the citizens of belligerent states was later recognised by the British Prize Courts during World War I and by the Privy Council (per Scrutton LJ).[6] Indeed, the rule against trading with the enemy is a corollary of the non-intercourse doctrine, and both English and US courts have extended it extraterritorially to apply to commercial transactions between third country nationals and the enemy, regardless of whether the proscribed transaction imposes a detriment against the sanctioning state or a benefit to its enemy.[7] Moreover, the US Supreme Court's broad definition of the term commercial transaction has served as a basis for the subsequent use of US economic sanctions to invalidate transactions between third country nationals and targeted states. As Justice Gray wrote in a 1869 case:

> 'The law of nations, as judicially declared, prohibits all intercourse between citizens of the two belligerents which is inconsistent with the state of war between their countries; and this includes any act of voluntary submission to the enemy or receiving his protection, as well as any act or contract which tends to increase his resources, and every kind of trading or commercial intercourse, whether by transmission of goods or money, or by orders for the delivery of either between the two countries, directly or indirectly, or through the intervention of third persons or partnerships, or by contracts in any form looking to or involving such transmission, or by insurances upon trade by or with the enemy.'[8]

This sweeping prohibition against 'every kind of trading or commercial intercourse, whether by transmission of goods or money' that were 'directly or indirectly, or through the intervention of third persons' benefiting the enemy state or its nationals raised important issues of civil and criminal liability for third parties and other neutrals who traded with belligerent states. Later, in 1917, Congress codified the broad reach of this prohibition when it enacted the Trading With The Enemy Act of 1917.[9]

In addition, there is some support for an overriding and universal principle of the law of war that recognises the prohibition against trading with the enemy. Lord Stowell first intimated this view in *The Hoop* case, in which he stated that the principle against trading with the enemy was not peculiar to English law and had been recognised by Bynkershoek as a 'universal principle of law'.[10] Later, however, this view was criticised by Lord McNair in his 'Legal Effects of Principles of Law', in which he examined the various bases for the law prohibiting trade with the enemy.[11] He stated that it was controversial whether there is any such rule in international law, and according to 'the law of many or most European countries, there is no *ipso facto* prohibition of intercourse, though the government of any belligerent State may lawfully prohibit it to its subjects.'[12] The absence of any uniform principle that prohibits trading with the enemy is also supported by the major treatises of Oppenheim and Schwarzenberger.[13] Indeed, the US law concerning contracts which cross the line of war appears to differ from English law insofar as certain contracts may be held to be suspended during war which under English law would be held to be abrogated.[14] The variety of views expressed by these authorities has led some common law judges to reject the notion that there is a generally applicable principle of international law nor uniformly accepted standard relating to trading with the enemy.[15] On the contrary, some judges have recognised that because the English common law rule derives from the Royal Prerogative, one cannot expect the law of countries with written constitutions to be the same.[16] Moreover, the divergence of state practice in this area and the less than uniform position of publicists confirm the view that there exists no rule of customary international law nor general principle of law that espouses a uniform set of rules against trading with the enemy.

B. Trading with the Enemy at Statute

As a matter of English law, it is recognised by legislation that the common law is co-extensive with and complementary to legislation.[17] Accordingly, ss1(2) and 5 of the Trading with the Enemy Act 1914, expressly preserved the common law; and section 16 of the Trading with the Enemy Act 1939, expressly provided that the Act 'shall be without prejudice to the exercise of any right or prerogative of the Crown'.[18] For example, trading with the enemy was a crime at common law. The British Government codified this rule by enacting the Proclamation of 5 August 1914 that prohibited trade with Germany and designated, *inter alia*, any contract to raise a loan on behalf of the enemy entered into by a British national or British-controlled entity to be a treasonous act under the Statute of Treasons.[19] By contrast, under Indian law, there was no such offence at common law for trading with the enemy, for all such offences were laid down by the Indian Trading with the Enemy Act. [20]

The old common law distinguished between trading with the enemy and contracting with the enemy.[21]

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Trading with the enemy involved the supplying of goods to, or obtaining goods from, an enemy country, whereas contracting with the enemy covered a broader range of transactions that included contracts between British nationals and third country parties that indirectly benefited the enemy state and certain transactions between third country parties and the enemy state. When Parliament enacted the Trading with the Enemy Act 1939, it eliminated this distinction and, through subsequent Orders in Council, adopted a broad definition of prohibited trade that included contracts between neutral countries and specially-designated nationals that were for the benefit of the Axis powers.[22] The 1939 Act was given broad effect by British authorities to prohibit all trade, even neutral country trade, with the enemy state. The law against trading with the enemy was considered a nation's weapon of self-protection. Moreover, courts have recognised that it must be applied to modern circumstances to reflect changes in international commerce and trade. Although its principal objective has been to curtail the commercial resources of the enemy, other authorities have recognised a broader objective, that is, to prevent all unregulated intercourse with the enemy altogether.[23] Only in certain circumstances through Royal licence will trade with the enemy be permitted.

Royal Licences

A settled principle of English law is that anyone trading with an enemy without a licence commits an offence at common law as well as under the legislation. The Crown has enjoyed the prerogative of licensing transactions which it considers in the interests of the realm, and it may revoke them at any time.[24] For Commonwealth jurisdictions, the Royal Prerogative to issue licences to trade with the enemy ceases to apply to former colonies after their independence. Not only may such a licence be given to a British subject who is within the kingdom, but a licence may also be given to a British subject to reside and trade within enemy territory, or to an alien enemy to reside and trade within the United Kingdom, or to reside and trade with its native country.[25] Royal licences may be either general or special: a general licence permits all UK nationals, or foreign nationals, to trade with a particular country or in certain goods, while specific licences were typically issued for a specific transaction and with certain goods.[26] An example of a general licence was the Order in Council of 15 April 1854 during the Crimean War which permitted British subjects to trade with non-blocked Russian ports, if the goods were transported on neutral ships, but not in contraband.[27] Later, in the early days of World War II, the Board of Trade authorised a general licence as to fees in respect to patents, designs, and trade marks on 7 September 1939. The general licence authorised payment on behalf of any person, not an enemy, 'of any fees necessary for obtaining the grant or renewal of patents, or for obtaining the registration of designs or trade marks or the renewal of such registration, in enemy territory, and the payment to enemies of their charges and expenses'.[28] This licence would have applied to the payment of German attorneys' fees incurred by a British licensor seeking to have its intellectual property registered in Germany during the war.[29] The acquisition of such licences and their effect on commercial transactions involving enemy aliens were the subject of much litigation during the war years.[30]

Moreover, regarding business transacted before the outbreak of war with agencies or branches in enemy territory which traded solely for the account of a parent firm or company whose principal place of business was in allied territory or neutral territory, there was no requirement for British nationals to obtain licences to make payments on outstanding debts owed to such agencies or branch offices so long as the debts were incurred before war and such payment was made directly to the parent company in the allied or neutral country.[31] In the banking business, the Department of Treasury issued a specific licence authorising the branch and agency offices in London of Deutsche Bank, Dresdner Bank and the Disconto-Gesellschaft to operate in limited transactions involving contractual rights and obligations that had arisen before war.[32] These licences did not prevent a creditor from suing these foreign banks and other institutions for debts in English courts.[33] Although plaintiffs were allowed to pursue their lawsuits, they were not allowed, upon obtaining judgment, to seize the assets of the branches in the UK of such banks in order to satisfy a judgment debt, which ordinarily would have been discharged by these branches. Furthermore, any assets in the UK of an enemy financial institution that had been frozen by the Treasury Department could not be subject to execution pursuant to a civil judgment; all such post-judgment actions were stayed until the blocking orders were lifted. Similarly, US courts have interpreted US economic sanctions as permitting private plaintiffs to obtain litigation licences to pursue civil actions against specially-designated nationals in US court, but prohibiting them from attaching or pursuing post-judgment remedies against assets that are owned or controlled by SDNs and have been blocked by the Office of Foreign Assets Control.[34] The OFAC blocking orders result in a stay against any party seeking civil attachment, forfeiture, or post-judgment remedies against blocked property until economic sanctions have been lifted.

The Broad Scope of British Trade Controls

In the Second World War, the 1939 Trading with the Enemy Act defined trading with the enemy to have broad effect, covering any commercial, financial or other dealings with, or for the benefit of, an enemy. In

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particular, and without prejudice to the general definition, this consisted of:

(i) supplying any goods to or for the benefit of an enemy, or obtaining any goods from an enemy, or trading in, or carrying, any goods consigned to or from an enemy or destined for or coming from enemy territory; or
(ii) paying or transmitting any money, negotiable instruments or security for money to or for the benefit of an enemy or to a place in enemy territory; or
(iii) performing any obligation to, or discharging any obligation of, an enemy whether the obligation was undertaken before or after 3 September 1939;
(iv) doing anything which, elsewhere in the Act, is to be deemed as trading with the enemy, *eg* purchasing enemy currency.[35]

The English courts and British government gave sweeping effect to these prohibitions by applying them to indirect trade with third country nationals that benefited enemy states or nationals. British shippers and traders were prohibited from entering transactions that involved the 'carrying' of 'goods' that were consigned to third parties but were 'destined for or coming from enemy territory'. Similarly, British nationals could not make payments to third country nationals that benefited enemy states or nationals. Significantly, the Act abrogated the sanctity of contracts by prohibiting British nationals from 'performing any obligation to, or discharging any obligation of, an enemy whether the obligation was undertaken before or after 3 September 1939'.[36]

These prohibitions, however, did not apply to transactions involving a British national who obtained a Royal licence from the Secretary of State, Department of Treasury or the Board of Trade to conduct specific types of transactions.[37] These government agencies were authorised to issue licences to British persons who sought to receive payment from an enemy national for a sum of money due in respect of a transaction under which all obligations on the part of the recipient had been performed before the commencement of the war by reason of which the person from whom the payment was received became an enemy.[38] This provision was important for allowing British contractors that had conducted business in Germany before the war to receive payments from the German government or its nationals for work that had already been completed before the outbreak of war. Similarly, British investors and shareholders were allowed to obtain licences to receive interest and royalties on investments which had been made prior to the outbreak of war. Moreover, as mentioned above, the Board of Trade issued a general licence authorising payment to any person who performed services in obtaining the grant or renewal of rights to intellectual property on behalf of British nationals even if such payment must go to an enemy alien.

Similarly, the 1914 Trading with the Enemy Proclamation and the subsequent Orders in Council had also carved out exceptions to trade embargoes by allowing British nationals and third country nationals to apply for licences to conduct certain transactions with enemy nationals that the Government considered to be in the national interests. During World War I, there were several cases involving the offence of making payments to or for the benefit of the enemy. In *R v Kupfer*, the Privy Council decided that it was a crime during war for a UK person to pay a debt due from an alien enemy to a neutral.[39] In a later case, though, a British national was permitted a licence to collect payments on a debt due from a business entity located in Germany after the commencement of war with Germany based on a transaction that was entered into before the war.[40]

After this case, the British government began issuing licences to allow British creditors to receive debt payments from German nationals during wartime. The stated purpose of this policy was that such payments on the whole would divert a balance of money and resources from Germany to England that would strengthen the British economy and thus sustain its war effort.[41] This exemption, however, primarily benefited UK trading houses and other financial institutions that were deeply involved in trade finance with European borrowers during this period, and it is difficult to believe that such an exemption was approved without substantial pressure being exerted by British financial institutions.[42] Similarly, English courts ruled that there was no violation of the Trading with the Enemy Act when a British subject residing in the UK makes a payment that merely improves the position of an enemy by giving him further security that he will ultimately recover the money, and without an intention that the enemy, while such, shall benefit by it as a payment.[43] The rationale for this decision was that the rule against trading with the enemy was to prohibit any trade that would benefit the enemy *during* war, and not to disadvantage the enemy once the war had ended.[44]

In addition, the Privy Council held, in 1914, that insurance branches in the United Kingdom that were owned or controlled by enemy states or their nationals were considered alien enemies under the 1914 Trading with the Enemy Proclamation with which no transactions were permitted.[45] Later, during the Second World War, s 2(1) of the 1939 Trading With The Enemy Act eased such restrictions by allowing a branch of an insurance company that was owned or controlled by an enemy national to pay a claim of an insured British national, while also permitting British nationals to assert claims against the UK branches of enemy-controlled insurance companies for covered losses under insurance contracts. The 1939 Act also imposed sweeping prohibitions against third country nationals from 'supplying' goods to the enemy.[46] The

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Act makes no distinction as to ownership of the goods in question nor does it distinguish as to the nationality of the party shipping the goods. Therefore, an offence was committed under the Act if goods that were owned by third-country nationals were shipped or transported by a British national, wherever located, to an enemy state. Liability may also be imposed against a British national for facilitating the shipment of such goods to an enemy state, despite any previous contractual obligations to the contrary. Moreover, an offence is committed by the existence of any contractual obligation whereby a British national who ships or transports goods to a third country knows or has reason to know that a third country national will supply such goods to an enemy national.[47]

Significantly, the prohibition against trading with the enemy was also used as a defence against performance of contractual obligations by collateral parties who had entered contracts to supply, or with respect to payment conditions concerning the supply of, goods to British or third country nationals whose transactions with enemy states or their nationals have been blocked.[48] The extraterritorial scope of the British Trading with the Enemy Act had the effect of nullifying contractual obligations between third country persons and UK persons that directly or indirectly benefited the enemy.

1. Collateral Liability under the British Trading with the Enemy Act

Contracts which amount to trading with the enemy are not only void as between the immediate parties, but also, being illegal, taint all collateral transactions.[49] Indeed, the maxim *ex turpi causa oritur actio* is applied to vitiate an apparently innocent contract by the illegality of another contract to which it merely is collateral.[50] The illegality of contracts that violate the rule against trading with the enemy will also taint all such collateral contracts thereby preventing their enforcement in an action at law. Typically, a collateral contract will be considered tainted if an action to enforce it is founded upon the illegal act that invalidated the other contract.[51] The collateral effect of such illegal contracts is a well-established rule in English contract law and reflects the common law principle that one who knowingly enters into a contract with an improper object cannot enforce his rights thereunder. [52]

A contract designed to evade the Trading with The Enemy Act, by giving false information, or by misleading the appropriate authority into giving a licence to trade with the enemy, is illegal.[53] But if a UK national orders goods from a third country national who then could procure the goods from either a neutral or an enemy national, the contract will be presumed legal, unless the goods were in fact procured indirectly from the enemy.[54] English courts will also not enforce a contract in favour of a subject of an allied state, if such contract amounts to trading with the enemy. In *Kreglinger & Co v Cohen*,[55] the plaintiffs were Belgians carrying on business in Antwerp and London who had made c.i.f. contracts for the sale of hides to the defendant, who was a German doing business in Hamburg during the war while previously conducting business in London before the war. After the outbreak of war in 1914, the defendant repudiated the contracts and the plaintiffs brought suit in the London High Court for damages. The court held that because plaintiffs were subjects of an allied state, the contracts, having been entered into with a person who subsequently became an enemy national, became illegal under English law at the outbreak of war. Accordingly, after that date, any obligations under the contracts were no longer enforceable, and that therefore the plaintiffs were not entitled to recover.

Similarly, at common law, any contract in furtherance or in aid of trading with the enemy is void. Some early nineteenth century cases arising from English economic embargoes imposed during the Napoleonic wars support the proposition that a policy of insurance that covers goods that were at one time traded with the enemy is void, even though the insurance contract itself had a lawful purpose and the illegal act of trading with the enemy was an unrelated transaction.[56] In *Parkin v Dick*,[57] a collateral contract of insurance was ruled tainted because the insured goods had been exported in violation of the proclamation against trading with the enemy. The court held that the contract of insurance was unenforceable because it covered goods illegally exported even though such goods formed only a portion of the total cargo of the ship. Modern authorities also support this view that collateral contracts of insurance covering a ship or cargo may be vitiated by reason of the fact that the ship had embarked on an adventure prohibited by statute, such as trading with the enemy.[58]

Severability

English courts rely on two underlying principles for determining whether an illegal provision of a contract should be severed. First, the courts will not make a new contract for the parties if to do so would require rewriting the existing contract or altering its basic nature.[59] Under this principle, severance will not be allowed where the illegal covenant forms a main part of the consideration or where the provisions in the agreement are all closely related so that to sever one provision would completely rewrite the contract.

Second, the portions of a contract that are unenforceable because of illegality will not be severed unless to do so accords with public policy.[60] Specifically, if a person makes various promises for valuable consideration, one of which is a covenant not to compete with its employer in unlawful restraint of trade, the legal promises may be severable from the illegal, if the severance does not make a new contract for the parties. The parties must

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have so framed the contract as to make the severance for themselves. The courts will permit this 'if a blue pencil can be run through part of the contract', leaving the rest of it unaltered.[61] For the blue pencil test to apply, it is essential that 'the severed parts are independent of one another and can be severed without the severance affecting the meaning of the part remaining.'

By contrast, contracts which are illegal in circumstances involving trading with the enemy will not be severed.[62] Generally, if any part of the consideration for a promise is that the promisee will trade with the enemy, the legal part of the consideration cannot be severed from the illegal part, and the whole contract is unlawful.[63] The rationale for this is that the courts consider trading with the enemy to be such a grave offence that it taints the whole contract, and that there is no ground of public policy requiring the courts to assist the parties in severing the offending parts.[64] English courts have held that a payment in breach of United Nations sanctions, as enacted in the relevant domestic law, is akin to trading with the enemy and it would be contrary to English public policy to sever the illegal portion of the contract authorising such payment. [65]

Termination of Contractual Obligation Because of War

A special feature of the English common law rule against trading with the enemy is that it generally treats all contracts involving intercourse with an enemy as abrogated on the outbreak of war.[66] English common law has generally recognised that obligations arising out of a contract for service are terminated on the outbreak of war.[67] Indeed, the oft-cited and classic statement of Mr. Justice Willes in *Esposito v Bowden*,[68] has been repeatedly echoed in the case law that the 'force of a declaration of war is equal to that of an Act of Parliament prohibiting intercourse with the enemy except by the Queen's licence.' Such an act of state, undertaken through the Prerogative that exclusively belongs to the Crown, carries with it all the force of law. The case law covers situations in which some unlicensed and therefore unlawful activity had either already been committed since the outbreak of war, or in which the performance of a pre-war contract clearly became unlawful on the outbreak of war without any possibility of validation by licence. If an illegality has already been committed it cannot be validated by a subsequent licence.[69] Similarly, if the continued performance after the outbreak of war of a pre-existing contract inevitably and immediately involves illegal intercourse with an enemy, then the contract cannot be saved by a subsequent Order in Council.[70] But the transaction will be lawful if a licence is obtained before the illegal act is committed.[71] Similarly, the rule against trading with the enemy will also abrogate contracts governed by foreign law involving UK nationals if the object of the contract is to trade with the enemy.[72] In *Ertel Bieber & Co v Rio Tinto Co Ltd*, the House of Lords ruled that contracts governed by German law that were entered into between UK and German nationals before the outbreak of World War I were void, although the contract contained provisions requiring the parties to resume performance after the war. [73]

Moreover, an arbitration clause in a contract will be unenforceable if its underlying contract is invalidated on account of illegality. Such illegality may arise from trading with the enemy or violating other economic sanctions laws. In today's international commercial environment, this issue has taken on particular significance with the increased use of arbitration clauses in international commercial agreements. The House of Lords addressed this issue in *Dalmia v National Bank of Pakistan*,[74] where the defendant bank argued that plaintiff should not be able to enforce an arbitration award against it in Pakistani courts because the contract authorising the arbitration had been abrogated by the outbreak of hostilities in 1965 between India and Pakistan, and thereby the contract's arbitration clause should have been abrogated as well. The court accepted the defendant's argument but only to the extent that it agreed that arbitration clauses in contracts will be automatically abrogated by the outbreak of war if the contract itself is abrogated; but if the provisions in a contract are merely suspended during war or other emergency only to be revived once again after the emergency period has ended, the arbitration clause will also survive the contract's suspension period.

Regarding executory contracts, where obligations remained to be performed by both parties after the outbreak of war or imposition of economic sanctions, the Court of Appeal has ruled that they must be abrogated because to enforce the unperformed obligations on both sides of such contracts during war or other emergency would violate the foreign policy objectives of the national government.[75] This more recent interpretation contrasts somewhat with the view of English courts before World War I when there was no statutory authority governing the effect of war on contracts between British nationals and aliens who later became enemies. The first case to address the issue was *Zinc Corporation, Ltd and Romaine v Skipworth*[76] in which Sargant J stated that it was not contrary to public policy for a contract made before war to provide that after war trading could be resumed with persons who were in the meantime alien enemies, but that where the performance of the contract becomes impracticable because of its wartime suspension, it will be rendered void. This holding was later codified, in part, by Parliament when it enacted in 1915 the Legal Proceedings Against the Enemies Act, which the courts subsequently interpreted as abrogating certain types of executory contracts entered into with enemy aliens before the outbreak of war.[77] The main principles and rules of these cases can be summarised as follows: that an executory contract concluded with an alien enemy before war will be dissolved if:

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(1) it enures to the aid of the enemy;
(2) if it is detrimental to British interests by obstructing the development of British trading during war;
(3) if it necessarily involves intercourse with the enemy of any kind; or
(4) where time is of the essence for the contract. [78]

II. Frustration, Impossibility & Foreign Illegality

The issue of frustration of purpose arises in the context of economic sanctions most often when a contract lawfully into by third country nationals subsequently becomes unlawful under the laws of a foreign and friendly country because of the extraterritorial application of economic sanctions. English courts have traditionally refused to enforce such contracts as a matter of public policy on the grounds of supervening illegality of foreign law.[79] The modern origins of the frustration doctrine with respect to economic sanctions derives from the House of Lords decision in *Horlock v Beal* in which it held that a party may cease to be entitled to benefits under a contract as soon as further performance under the contract becomes impossible.[80] In this case, a seaman had signed a contract to serve on a ship for not more than two years in May 1914, but when war broke out between Germany and England in August 1914, the ship on which the seaman served was seized as prize by German authorities in a German port and the seaman was later imprisoned. The seaman's wife later brought suit on behalf of her husband for wages due for the remainder of the contract. A majority of the Lords ruled that further performance on the contract between seaman and shipper had become impossible on the date of the ship's detention and that this terminated the contract of service between the shipowner and the crew.

Lord Atkinson stated that the sole question was whether the facts established satisfactorily that the respondent's husband had ceased to be entitled to his wages from the outbreak of war, or, if not, from what date, if at all. He cited a rule laid down by Blackburn J, in *Taylor v Caldwell,*[81] which stated that when there is a positive contract to do a thing, not in itself unlawful, the contractor must perform it or pay damages for not doing it, even though because of unforeseen events the performance of the contract has become burdensome or even impossible.[82] But this rule is only applicable when the contract is positive and absolute, and not subject to any condition express or implied. If, from the nature of the contract, it appears that the parties must have known from the outset "that it could not be fulfilled unless, when the time of fulfillment of the contract arrived, some particular specified thing continued to exist", so that, when entering the contract, the parties must have contemplated the continuing existence or absence of this fact that was fundamental to the purpose of the agreement and which was expected to have occurred or not have occurred. In the absence of any express or implied warranty that this thing shall exist, the contract is not to be construed as a positive contract, but as subject to an implied condition that the parties shall be excused performance in case, before breach, performance becomes impossible from the absence of the thing expected to have occurred without fault of the contractor.

In this case, the contract with the crew was not a positive and absolute contract, for there was an implied condition that the adventure should continue to be possible. Lord Shaw said that, 'without fault of either party to the contract of service, law and force combined to stop the prosecution of the voyage', and such related contracts were therefore 'brought to an end by the declaration of the war', and accordingly the contract of service between the ship owner and the crew was terminated in the same way because it was a contract 'whose incidents' stood or fell 'with the adventure with which it was bound up.'[83] The rationale behind the decision was the failure of a basic assumption underlying the contract in the minds and intentions of the contracting parties.

English law would apply this principle not only to cases where performance became impossible by the cessation of existence of the thing which was the subject matter of the contract, but also to cases where the event that rendered the contract incapable of performance was the cessation or non-performance of an express condition or state of things that was fundamental to the contract. Indeed, there is authority for the proposition that when two third country nationals enter a contract governed by English law that requires performance of an act in the United States that later becomes illegal because of US economic sanctions, one of the parties may have a defence against performance based on the above principle that a fundamental assumption of the contract that was presumed by the parties to be in place at the time of making the contract did not occur because of the supervening illegality of economic sanctions. This position is based on the rule adopted by the Court of Appeal in the controversial case of *Ralli Bros v Compania Naviera Sota y Aznar* which held that a contract is unenforceable in an English court if it requires performance in a country under whose laws such performance is, or becomes, illegal.[84]

In this case, Spanish shippers sued English charterers on a claim to recover the amount of freight due on a charter-party agreement to which they were contractually entitled in respect of goods delivered in Spain.[85] After the parties entered into the contract governed by English law, but before delivery was due, Spanish authorities imposed a new law that limited the amount of freight which a ship owner could charge. The defendant paid the amount of freight to the plaintiff up to the limit permitted by Spanish law and rejected any further amount on the grounds that the new law had frustrated the contract and/or made it illegal under Spanish law. The Court held that although the contract

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was not void for illegality, the contract could not be enforced in an English court as a matter of public policy because performance had become illegal in the place of performance, thus frustrating the purpose of the contract. As a result, the court held that the amount of freight due above the legal limit was irrecoverable in English proceedings because contracts to charge more had become illegal in the place of performance.

Some scholars have suggested that the rationale of the *Ralli Bros* case was based on international (public policy) and the recognition by the English court of mandatory rules of Spanish law.[86] Other scholars reject this view by arguing that the case had nothing to do with mandatory rules or public policy, as there was no attempt on the part of the parties to evade Spanish mandatory rules because, at the time they entered the contract, they were wholly innocent of any illegal intent because the prohibitory rules were not in effect. Instead, this view holds that the Court of Appeal treated the Spanish legislation as a frustrating event by relying on cases of supervening illegality by British legislation.[87] This view holds that whether an English contract is frustrated by events that occur abroad is a matter of English law.[88] The ruling in *Ralli Bros.* has been upheld in subsequent decisions[89] and has been further confirmed by s 10(1)(d) of the Rome Convention,[90] which under its terms would permit the enactment of a law by a member state of the European Community to extinguish, in part, a defendant's obligation or rights under a contract. [91]

Today, the English law of frustration of purpose is stated in s 1 of the Law Reform (Frustrated Contracts) Act 1943, which provides that where an English contract has become impossible of performance or otherwise been frustrated, thus resulting in the parties being discharged from any further performance, the parties shall be entitled to recover '[a]ll sums paid or payable to any party in pursuance of the contract before the time when the parties were so discharged.'[92] This statutory provision was the basis for one of the claims in *Libyan Arab Foreign Bank v Bankers Trust Co*,[93] where the extra-territorial application of US economic sanctions against Libya had resulted in a freeze order against 'all property and interests in property of the Government of Libya, its agencies, instrumentalities and controlled entities' that were in the 'possession or control of U.S. persons including overseas branches of U.S. persons'.[94] Bankers Trust complied with the order by blocking over three hundred million US$ in accounts it held for the Libyan Arab Foreign Bank at both its London and New York branches. After US sanctions went into effect on 8 January 1986, the Libyan bank demanded payment in cash (US$ or sterling) or, in the alternative, a banker's draft for the amount of the credit in its account. Bankers Trust stated that it was impossible for them to comply with their customer's demand because to do so would require them to violate US economic sanctions laws.[95] In the following civil action, the Libyan bank asserted several claims, one of which was a demand for recovery of the money that they had deposited with Bankers Trust. This claim was based on the Law Reform (Frustrated Contracts) Act 1943 in which it was argued that the credit in their London account ($131 million) and the additional amount ($161.4 million), which they argued should have been transferred to the London account, had totalled the balance of sums that had been deposited with Bankers Trust; and, assuming defendant's argument that the contract between them had become impossible or frustrated by reason of the economic sanctions order, that plaintiff was entitled to recover those sums from defendant under s 1 of the Act or at common law.

Staughton J rejected this argument by stating that s 1 required that a party's obligation to perform had to be discharged in order for another party to recover sums already paid pursuant to the contract; but in this case the effect of the blocking order had been to suspend, and not to discharge, the contractual obligations of Bankers Trust to pay plaintiff's claim.[96] Accordingly, because the defendant's obligations had been suspended and not discharged for the period the sanctions remained in effect, the contract as a whole had not become impossible of performance or otherwise frustrated.[97] Moreover, Mr Justice Staughton observed that no restitutionary claim could prevail at common law because the consideration given by Bankers Trust had not totally failed because the bank remained under US law obliged to pay the amount owed to the plaintiff at some time in the future whenever the sanctions were lifted with interest added to the claim.

III. The Doctrine of Foreign Illegality as a Defence against Collateral Claims under English Law

A. English Law: Foreign Illegality and Public Policy

The connection of a contract to more than one country exposes it to various limitations on freedom of contract based on the national legal systems of many states. An important limitation on freedom of contract under English law is the doctrine of foreign illegality. Although some scholars state that it is unclear what role foreign illegality plays in English law,[98] there is a substantial weight of authority that supports the proposition that an English court will not enforce a contract, or award damages for its breach, if its performance involves the doing of an act in a foreign and friendly state which violates the law of that state.[99] Despite this authority, it is unclear if this rule relates more to the conflict of laws rather than to the domestic law of frustration of purpose. In most of the relevant cases, either the contract was unenforceable because it offended against the public policy of English law, the *lex fori*, or the proper law of the contract was English law and the contract was invalidated by a rule of English domestic

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law. The increasing recognition of this rule in other legal systems can be attributed principally to the globalisation of commercial activity and the importance of international comity as a principle in national legal systems. Accordingly, the law of the 1980 Rome Convention on the Law Applicable to Contractual Obligations permits member states of the European Union to invoke public policy against the enforcement of a foreign contract that violates the laws of a foreign and friendly state. [100]

1. Origins

The English doctrine of foreign illegality has evolved from an earlier era when considerations of international comity were far less important than the unfettered pursuit of the British national interests so that contracts governed by English law involving a UK national and which required an act to be performed in a foreign country in violation of that country's laws were held valid and enforceable against the party whose breach was alleged. This view was expressed in 1734 by then Lord Chief Justice, Lord Hardwicke, who, in *Boucher v Lawson,*[101] upheld the enforcement of a contract governed by English law to export gold from Portugal to England, even though the export of gold from Portugal was prohibited by Portuguese law. This rule was partially eroded in a 1824 case where the court denied enforcement of a contract the recognition of which would have constituted a hostile act against a foreign friendly government.[102] But the older rule maintained its resonance into the twentieth century when Lord Wrenbury stated: 'Illegality according to the law of another country does not affect the merchant.'[103]

At present, however, English law demands in certain cases 'deference to international comity' and prohibits the robust 'assertion in favour of national interest to the prejudice of international comity'.[104] The accepted view that has emerged states that a contract will not be enforced when it is illegal under foreign law, and both parties were aware of such illegality.[105] In the context of the extraterritorial application of US economic sanctions, the issues becomes whether an English court will enforce a contract governed by the law of a third country between two private parties which involves a transaction that violates the economic sanctions laws of a foreign and friendly government, namely the United States.

2. English Contracts and Foreign Illegality

A fundamental rule of English public policy holds that a contract governed by English law will be void if it is opposed to British interests of State which may jeopardise friendly relations between the British Government and other states.[106] Similarly, if the making of the contract is expressly or impliedly prohibited by statute or is otherwise contrary to public policy, it will be void *ab initio*. For example, where a contract governed by English law is contrary to the public policy of the state where it is to be performed, English courts will generally bar its enforcement if two conditions are met:

(1) the contract relates 'to an adventure which is contrary to a head of English public policy which is founded on general principles of morality'; and
(2) the country where the contract is required to be performed has the same public policy so that the agreement would not be enforceable under its laws.[107]

This rule was applied in *Lemenda Trading Co Ltd v African Middle East Petroleum Co Ltd* where plaintiffs entered a contract governed by English Law to procure for a fee the renewal of an oil supply contract between the defendants and the Government of Qatar. After securing renewal of the contract for defendants, plaintiffs filed an action to recover their fee. The court denied enforcement of the contract because its purpose was to secure benefits from persons in public office which was a violation of generally accepted principles of morality that underlie the principles of English public policy.[108] Further, the court observed that there was evidence to show that the law of Qatar also prohibited such contracts, and therefore 'international comity combines with English domestic public policy to militate against enforcement.' [109]

At English common law, just as public policy avoided contracts which offended English law and morality, it will also void most contracts, entered into between private parties, which violate the laws of a foreign state, principally because today public policy demands deference to comity. An important case to give force to this principle was *Foster v Driscoll* where the Court of Appeal ruled that a contract will be invalid if, at the time of its conclusion, the real object and intention of the parties was for it to be performed in a way which was unlawful under the laws of the place of performance.[110] The Appeal Court upheld the trial court's refusal to enforce a contract made in England by UK nationals resident in England calling for the importation of whiskey into the United States during the prohibition era. Sankey LJ stated his view as follows:

> '[A]n English contract should and will be held invalid on account of illegality if the real object and intention of the parties necessitates them joining in an endeavour to perform in a foreign and friendly country some act which is illegal by the law of such country notwithstanding the fact that there may be, in a certain event, alternative modes or places of performing which permit the contract to be performed legally.'[111]

Lawrence LJ adopted a broader principle of foreign illegality that would invalidate an English contract if it were 'formed for the main purpose of deriving profit

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from the commission of a criminal offence in a foreign and friendly country'.[112] This wider principle does not *necessitate* the parties 'joining' in a criminal act to be done in a foreign and friendly country. Instead, they could have designated agents or other third parties to commit the relevant acts that were criminal under the laws of the foreign state. Both Justices considered the enforcement of such contracts to be a breach of international comity and thereby a violation of English public policy. Moreover, the court considered it important that the parties involved had intended the contract to be performed in a manner that both parties knew would infringe the law of the United States.[113] The decision in *Foster v Driscoll* enlarged the category of contracts governed by English law that would not be enforced by English courts as a matter of public policy on account of foreign illegality.

Later, in 1957, the House of Lords in *Regazzoni v K.C. Sethia Ltd*[114] further expanded the principle of foreign illegality adopted in *Foster v Driscoll* that English courts could not be used to enforce or award damages for the breach of a contract which involved the doing in a foreign and friendly country an act illegal under that country's laws.[115] In *Regazzoni*,[116] a contract governed by English law required the English seller to sell to the Swiss buyer a quantity of Indian jute bags c.i.f. Genoa. The seller was aware that the buyer intended to reship the goods at Genoa to South Africa in the knowledge that such contracts were illegal in India. Further, the buyer knew that the seller was obliged to procure the jute bags from a supplier in India in violation of Indian law, which prohibited the export of any goods which 'are destined for the Union of South Africa.'[117] The English court refused to enforce the contract, either by way of specific performance or damages, because from the beginning the contract was tainted by its illegality under Indian law so that the courts would assist neither party in enforcing it.[118] Lord Reid acknowledged this by stating:

> '[I]t is impossible for a court in this country to set itself up as a judge of the rights and wrongs of a controversy between two friendly countries. We cannot judge the motives or the justifications of governments of other countries in these matters and, if we tried to do so, the consequences might seriously prejudice international relations. By recognising this Indian law so that an agreement which involves a breach of that law within Indian territory is unenforceable we express no opinion whatever either favourable or adverse as to the policy which caused its enactment.'[119]

Similarly, Lord Keith stated:

> 'The Indian law is not a law repugnant to English conceptions of what may be regarded as within the ordinary field of legislation or administrative order even in this country. *It is the illegality under the foreign law that is to be considered and not the effect of the foreign law on another country.*'[120]

Accordingly, Dr Mann deduced from *Regazzoni* a negative rule: namely, that it is not contrary to English public policy to apply the law of a foreign and friendly State, which, by its express terms, imposes an embargo upon the supply of goods to another foreign and friendly state, even if the supply of such embargoed goods is undertaken by third country nationals.[121] Interestingly, the English law's attitude towards an economic boycott outside of war contrasts significantly with how the English courts have viewed contracts seeking to circumvent a blockade which is imposed by foreign belligerents in a war in which Britain is neutral. Although such contracts violate the law of belligerent states, English courts have upheld them as valid and effective.[122] Similarly, the High Courts of Switzerland, Holland and other civil law jurisdictions have adopted decrees, which in the course of the two world wars were issued in belligerent countries and directed against other belligerent States in which neutrality was held to require the non-recognition of wartime embargoes.[123] Although the House was not concerned with a state of war in *Regazzoni*, it did deal with a dispute between two friendly states that required a decision that would have offended the policy of one state. Indeed, as Dr Mann observed, if India had had just cause for complaint about its enforcement of the contract, South Africa would have had no less cause for complaint about its non-enforcement.[124]

The effect of the rule of *Regazzoni* is that illegality under foreign law renders certain contracts illegal under English law. The stricter doctrine of foreign illegality enunciated by the House of Lords in *Regazzoni* is stricter than that followed in other countries.[125] Moreover, the principle stated in *Regazzoni* appears not to be confined merely to contracts governed by English law, but also to contracts where the proper law is foreign.[126] This was demonstrated in the recent case of *Soleimany v Soleimany*[127] where the Court of Appeal refused to enforce a foreign arbitration award in England that was based on a claim by one Iranian national against another (the defendant was domiciled in England) for damages arising out of a contract where the parties had smuggled carpets out of Iran in violation of its export control and excise laws. The *ratio decidendi* of the case was that an English court will not enforce a foreign arbitration award that was based on a contract that was illegal under its governing foreign law where the parties had intended to violate the export control laws of a foreign and friendly country.

The same principle of English public policy avoids an English law contract if its object is to violate the import or export laws of a friendly country, such as the US prohibition legislation or the Indian export control prohibitions against South Africa.[128] The principle also applies if the laws in question are revenue, penal or

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foreign exchange laws.[129] Although English courts will refuse to enforce foreign revenue or penal laws or contracts to enforce the payment of taxes,[130] they nevertheless will not enforce a contract which involves the breach of such laws.[131] An English law contract, however, made for the purpose of violating a foreign law that recognises slavery or any other law against international human rights or morality will not offend English public policy. [132]

The crucial issue then is what English contracts between third country nationals involving trade with countries or persons targeted by US economic sanctions become illegal as a matter of English public policy according to the principle of foreign illegality as established in the *Regazzoni* case. What is it that taints the contract with illegality? Indeed, the principle in *Regazzoni* could be applied to invalidate collateral contracts entered into between third country nationals who intend to evade US economic sanctions. For example, by a contract governed by English law, A, who carries on business in England, agrees to sell B, who carries on business in Germany, machine lasers c.i.f. Genoa. Both parties know that the United States is the only possible source of supply, that B intends to resell the lasers to Cuba, that it is a violation of US law to ship laser equipment from the US if the ultimate destination is Cuba, and that the US shippers from whom B is to acquire the lasers will have to deceive US authorities to conduct the transaction. Since both parties contemplated and intended to induce the commission of an illegal act under the laws of a friendly country, and since the contract cannot be performed without this act, it is illegal and void. Thus, the extra-territorial application of US sanctions would render English contracts involving third country nationals unenforceable on account of foreign illegality because to enforce such contracts would violate English public policy. In this application, it is immaterial whether the contract is governed by English or foreign law.[133] Therefore, where it is the common intention of the parties to violate laws of the United States, namely, its economic sanctions laws, any contract to that effect, regardless of its proper law, would not under these principles be enforced by an English court.

In addition, there is another variation on the principle of foreign illegality that Dicey and Morris accept as standing for the proposition that a contract will be invalid if and insofar as it requires or necessarily involves performance which is unlawful by the place of performance. This view is based on the Court of Appeal's decision in *Ralli Bros* which, as discussed above, some scholars consider solely to be a statement of the English domestic law of frustration. Other authorities, however, interpret the case as reflecting a variation on the rule against foreign illegality that states that a contract will not be enforced if, at the time of its conclusion, its performance necessarily involves an act that is or has become illegal in the country of performance.[134] In *Ralli Bros.*,[135] it was held that although the charter-party agreement was a contract governed by English law, it was invalidated in so far as its performance was illegal by the *lex loci solutionis* (in this case, the law of Spain), and that the charterers were not therefore obliged to pay the excess of freight over the limit prescribed by Spanish law.[136] This view was expressed by Scrutton LJ who, citing Dicey, stated:

> 'If I am asked whether the true intent of the parties is that one has undertaken to do an act though it is illegal by the law of the place in which the act is to be done, and though that law is the law of his own country; or whether their true intent was that the doing of that act is subject to the implied condition that it shall be legal for him to do the act in the place where it has to be done, I have no hesitation in choosing the second alternative. "I will do it provided I can legally do so" seems to me infinitely preferable to and more likely than "I will do it, though, it is illegal."'[137]

Lord Justice Scrutton went on to state that where 'a contract requires an act to be done in a foreign country, it is, in the absence of any circumstances, an implied term of the continuing validity of such a provision that the act to be done in the foreign country should not be illegal by the law of that country.'[138] The contract was held to be unenforceable in England because partial payment under the contract was required to be made in Spain on terms that were illegal under Spanish law. It is important to note that the intent of the parties to commit an unlawful act in Spain was not an important factor in the court's decision.[139] Dicey and Morris view the case as standing for the proposition that a contract is generally invalid in so far as the performance of it is unlawful by the law of the country where the contract is to be performed, even though neither party intended, at the time they entered the agreement, to perform an illegal act under the laws of a foreign country. The *Ralli Bros.* decision has been controversial and its rationale has been questioned. [140]

Based on these cases and principles, there are circumstances in which English courts will refuse to enforce or recognise the validity of contracts governed by English or foreign law that requires performance in a third country, such as the United States, in violation of its economic sanctions laws. In *Soleimany*, although the contract was governed by Iranian law and its place of performance was in Iran, and a foreign arbitrator had awarded damages to the plaintiff, the English court refused to enforce the award based on British public policy because the contract was void under Iranian law and that to enforce the contract would violate the laws of a foreign and friendly country.[141] Morever, the *Regazzoni* decision suggests that an English court would deny enforcement of a contract governed by English law between third country nationals whose intention was to procure goods or services from the United States for the

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purpose of dealing with states or entities that are targeted by US economic sanctions.[142]

B. Foreign Contracts, Illegality and The Rome Convention

A general principle of the conflict of laws provides that the forum court will not apply a foreign law which is contrary to the public policy of the forum. Indeed, it is a general principle of the world's leading legal systems that courts will apply to a case otherwise governed by foreign law those fundamental principles of their own law (*lex fori*) which express basic notions of public policy.[143] English courts, however, are more reluctant to invoke public policy in cases involving primarily foreign legal issues and parties, rather than when purely local legal issues are involved.[144] This public policy rule of the forum may have two results:

(1) it may induce a court to invoke public policy as grounds to regard a contract as void or unenforceable even if the contract is valid under its foreign governing law; and,
(2) conversely, it may result in an English court enforcing a contract governed by foreign law, although, under that law, the defendant has been excused from performance.

This general principle of English public policy is recognised in Art 16 of the Rome Convention which states that the 'application of a rule of law of any country specified by this Convention may be refused only if such application is manifestly incompatible with the public policy ("*ordre public*") of the forum.'[145] Article 16 clearly reflects the pre-existing English common law with respect to contracts, except for the expression 'manifestly incompatible',[146] which derives from the Hague Convention and expresses the view that resort to the public policy doctrine should only be made when the enforcement of a foreign law would impinge important legal principles of the forum.[147] Under pre-existing English law, an English court was not justified in excluding foreign law as a matter of public policy in a case where there was a mere difference between the *lex fori* and the foreign law, or where the rule of public policy was of exclusively domestic concern.[148] Similarly, the US rule holds that courts will not refuse to enforce or recognise a foreign right unless it violated 'some fundamental principle of justice, some prevalent conception of good morals, some deep-rooted tradition of the common weal.'[149]

In addition, it is important to note that Art 16 and English common law are concerned with international public policy, rather than with public policy in a domestic sense. An English court may not invalidate a contract valid by its foreign law on account of domestic public policy, even if the contract lacks an essential element for its validity under English law, i.e. consideration.[150] To invalidate the contract, there must be some fundamental objection to it based on principles of international public policy.[151] Such a determination would be made based on the facts of each case. For example, there are some foreign contracts that an English court will refuse to enforce because the contract, or the circumstances in which it was made, was 'contrary to morality' or to some 'essential moral interests'[152] These 'essential moral interests' are recognised as having universal effect and ordinarily are principles of international public policy. The courts will regard some domestic common law principles as expressing a basic public policy, in an international sense, and will enforce such principles in cases where foreign law would otherwise apply. This is exemplified by the French law maxim: 'not every rule of law which belongs to the '*ordre public interne*' is necessarily part of the '*ordre public externe or international*'.[153]

The general rule under both Art 16 and pre-existing English law is that the determination of whether the foreign law is incompatible with English public policy must be based on the foreign law's application to the facts of a specific case, rather than on the content of the foreign law as such.[154] There are some cases, however, where the foreign law in the abstract represented such a gross violation of human rights that the law *per se* would not be recognised at all.[155] In the more typical case though, both at common law and under Art 16, a foreign law should only be excluded because it is contrary to public policy in a particular case.[156] Similarly, the determination of whether public policy should be invoked to exclude rights under a foreign law contract depends on the circumstances of each case. A number of factors will be considered, namely, whether the foreign contract has a connection with England or has implications which directly affect English policy.[157] For example, an English court will refuse to enforce a foreign contract that requires acts to be performed in England that are criminal at either common law or by statute, notwithstanding the contract's legality under its governing law.[158] Moreover, the application of public policy in this sense has led English courts to void certain contracts, such as those in restraint of trade,[159] involving trade with the enemy,[160] or champerty,[161] although these contracts were governed by foreign legal systems according to which they would have been valid under general principles of private international law.

Where a contract is valid by its foreign law, but violates an English regulatory statute that would have rendered an English law contract void or unenforceable but not illegal, the enforceability of the foreign agreement will depend on the regulatory statute in question.[162] There is scholarly support for the view that such agreements should be enforced unless the social policy expressed in the English statute is of such paramount importance that it must be applied even to a transaction with foreign elements or unless the contract, or its breach, has a substantial contact with England. This seems to accord with both Arts 16 and 7.2 which allow the application of the 'rules of law of the forum in

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a situation where they are mandatory irrespective of the law otherwise applicable to the contract.'[163]

Another category of cases involves the application of English public policy to foreign contracts that have been wholly or partially invalidated by foreign legislation. In this situation, a court may disregard the legislation if its application is manifestly contrary to public policy. This may result in the contract being enforceable in England, but not enforceable under its governing law. Similarly, there have been cases where an English court has refused, on grounds of public policy, to recognise the effect of legislation of a country where that legislation has been relied on by way of defence to a claim under a contract governed by the law of that country.[164] In *re Fried Krupp AG*, a UK national had a claim under a contract governed by German law against a German national with an English forum clause. Under German law, the claim would ordinarily have carried interest; but a German ordinance had purported to extinguish the right of non-German parties to seek such interest on claims against German parties. Justice Younger refused to recognise the effect of this ordinance because, *inter alia*, it was 'not conformable to the usage of nations'.[165]

English courts have followed this decision by ignoring foreign legislation that deprives a contract of its effectiveness if the legislation to which the contract is opposed is regarded by English law as so discriminatory or oppressive as to violate public policy,[166] or otherwise seriously infringes human rights.[167] Moreover, they will recognise the contractual rights of third country nationals to a contract that was invalidated under its governing law by foreign exchange legislation when such legislation has been enacted not 'with the genuine object of protecting the State's economy,' but as 'an instrument of oppression and discrimination.' The application of these principles in the context of US economic sanctions poses the important issue of whether a contract governed by US law involving, for instance, UK nationals may be deprived of its effectiveness in the eyes of an English court by the extraterritorial application of US sanctions. Should the English court consider the extraterritorial application of US economic sanctions to rise to the level of 'an instrument of oppression and discrimination'? Or even a violation of human rights? Indeed, it seems difficult to equate the invidious discrimination of the German legislation in *Re Fried Krupp*, which prohibited foreign nationals in a German contract dispute from claiming interest against German defendants, with the extraterritorial nature of US economic sanctions, which applies equally to US citizens and third country nationals alike if they are involved in direct or indirect trade between the United States and targeted states. There is some authority, however, for the proposition that certain foreign laws of extraterritorial application that purport to make contracts illegal under their governing law will not be recognised by English courts, thereby resulting in such contracts invalid by their governing law being enforced.[168] But it is hard to ignore the rule of *Foster v Driscoll* that an English court will refuse to enforce a contract - regardless of its governing law - where it was the object of the parties to violate the laws of a foreign country. If the parties to the contract, however, have no 'wicked intention' to break or assist in breaking such laws, the contracts will not be invalidated, unless the prohibition forms part of the governing law of the contract.[169] For example, an English court refused to recognised a US court's decision to hold an English law contract entered into between two English companies as illegal based on the extraterritorial application of US anti-trust laws with the result that the English contract was enforceable in an English court. Although English courts upheld the extraterritorial application of the British Trading with the Enemy Act during the first two world wars, they have been reluctant in some circumstances to accord deference to the extraterritorial application of US anti-trust laws and economic sanctions, are now bound by European Regulation not to recognise any rights, powers or obligations arising out of the extraterritorial application of US economic sanctions.[170]

C. Financial Service Contracts and Foreign Illegality

The determination of foreign illegality with respect to banking and financial service contracts depends primarily on what the proper law of the contract is and, if the proper law is foreign, whether the enforcement of a foreign law or rule by an English court would violate English public policy. This was the crucial issue in *Kahler v Midland*,[171] which involved an action for breach of contract and in detinue by a Czech national domiciled in England against the London office of Midland Bank seeking return of certain securities that were in Midland's possession as a bailee for the bailor, a Czech bank.[172] Neither Midland nor its corresponding Czech bank claimed any beneficial interest or lien in the shares. The plaintiff based its claim for return of its securities on two points:

(1) that because the shares were domiciled in England, English law governed the contract of bailment; and therefore
(2) that English law entitled plaintiff to immediate return of the shares and that permission of the bailor Czech bank was unnecessary.

There was no dispute that the plaintiff was the owner of the shares in question, but the bank pleaded against the claim by arguing, *inter alia*, that they had held the share certificates to the order and for the account of the Czech bank and they were obliged not to transfer them without its assent, unless plaintiff could submit proof that it was entitled to immediate possession. Further, Midland argued that the Czech bank was unable to grant approval for transfer of the securities because Czech foreign exchange regulations prohibited the transfer of 'securities' or 'currency' by Czech banks,

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wherever such assets were located, to any person without the permission of the Czech National Bank.[173] Midland's contract was with the Czech bank to which it owed an obligation not to release the shares without its approval, thereby to compel Midland to transfer possession of the shares in England would result in an illegal act under the laws of Czechoslovakia.

Lord Normand recognised the narrow issue to be whether the owner of the shares had a right to their immediate delivery while on deposit in a London bank by a foreign bank in a foreign country the law of which restricted the disposal or transfer of possession of the securities in question. The Lords held that it was not sufficient that the plaintiff had established his title to ownership of the securities, for the defendant was entitled to demand proof that plaintiff was also entitled to immediate possession; and in this case possession depended on whether there was a contract between the plaintiff and the bailor, Czech bank, and, if so, what was the meaning and effect of that contract. Lord Normand observed that in order to prove whether plaintiff was entitled to possession, it was necessary to determine the proper law of the contract between plaintiff and the Czech bank.[174] Lord Simonds cited Dicey and Morris for the rule that, 'the proper law of a contract means the law . . . by which the parties intended, or may fairly be presumed to have intended, the contract to be governed.'[175]

In determining the proper law, the parties' intent will be controlling; but, in the absence of evidence that the parties intended a certain law to apply, 'the mode of performing a contract, as distinct from the substance of its obligation, is governed by the law of the place at which the obligation is to be performed.'[176] Based on this rule, the Lords were in agreement that because plaintiff, a Czech national, had opened the account with a Czech bank while residing in Czechoslovakia, that the parties intended Czech law to govern the contract.[177] Therefore, it became a matter of Czech law whether the Czech bank could authorise Midland to transfer the shares to plaintiff. Under the Czech foreign exchange law, this was impossible because it was illegal for the Czech bank to authorise any transfer of foreign securities owned by Czech persons, even if they were held by a foreign bank in a foreign jurisdiction, without the approval of the Czech National Bank.[178] Further, the Lords ruled that plaintiff had no privity of contract with defendant Midland and therefore could not prevail on a breach of contract claim. They also denied plaintiff's action in detinue because that claim could only be governed by the law of the bailment which was Czech law, under which the transfer of the shares without authorisation was illegal. Moreover, the Lords rejected plaintiff's argument that it would be a violation of English public policy and universal moral standards to recognise the validity of the Czech foreign exchange law in denying plaintiff's claim.

Kahler reaffirms the English legal principle that if the proper law of a contract is the law of a foreign country, English courts are required to apply that foreign law in determining the rights and obligations of the parties, unless to do so would violate essential moral interests or international public policy. In this case, the relevant contract was that between plaintiff and the Czech bank, which had deposited plaintiff's shares with an English bank under a contract of bailment that was governed by Czech law. Since the bailment was governed by Czech law, it was thereby illegal for it to be terminated in a manner that involved the transfer of the shares in violation of Czech law. Further, the recognition of the Czech foreign exchange law did not violate universal principles of public policy. Moreover, given that plaintiff's action in detinue was *in rem* because it was directed against securities located in England, it could be argued that the decision effectively recognised the extraterritorial effect of the Czech foreign exchange regulations.

By contrast, where the proper law of the contract is determined to be English law, English courts have typically enforced claims for money or assets against English or foreign financial institutions, although certain acts in performance thereof are illegal by their place of performance. Thus in *Kleinwort v Ungarische Baumwolle*,[179] the Court of Appeal enforced a promise by a Hungarian bank to an English bank pursuant to a contract governed by English law to provide cover in London of bills of exchange, although it was known by the parties that the approval of the Hungarian central bank was needed to authorise the Hungarian bank to fulfil its contractual obligations of making payments in hard currency (sterling) to the English bank at its London office. The defendant Hungarian bank pleaded against the claim by arguing illegality under Hungarian law. The appeal court held that the proper law of the contract was English law; and, since the contract was to be performed in England, it was enforceable in the English courts even though its performance might involve a breach by the defendants of Hungarian law. At the time the parties entered the contract, they never intended that the Hungarian bank should commit offences in Hungary. Instead, they had contemplated that if the central bank's consent were refused, the promisor would fail to pay, but would in effect be in breach of an absolute warranty that such permission would be granted.

In a later case involving a defendant's reliance on Turkish foreign exchange regulations as a defence against performance of an English law contract,[180] Turkish buyers of wheat agreed to open a letter of credit 'with and confirmed by a first class United States or West European Bank.' The buyers were unable to obtain exchange control permission from the Turkish Ministry of Finance to open a letter of credit, confirmed by a first-class West European or US bank. The buyers argued that, although there was no express or implied term of the contract requiring any act to be done in

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Turkey, nevertheless it was contemplated by both parties that the Turkish buyers would have to undertake the necessary steps in Turkey to obtain exchange control approval; and accordingly if this contemplated method of performance became illegal under Turkish law, it would be an answer to the claim based on foreign illegality or the domestic law principle of frustration. The court rejected these arguments by ruling that the contract's terms required only that the letter of credit be confirmed by a major US or European bank, and that the sellers were not in the least concerned with the method by which the Turkish buyers were to provide the letter of credit.[181] Any obstructions posed by the Turkish government - ie refusing foreign exchange applications - were matters that were extraneous to the contract and afforded no defence to an English contract.[182] Therefore, when the state enterprise had failed to obtain permission from the Turkish government to open the letter of credit, they could not plead frustration or foreign illegality. The specific rule that emerged from the case was that it is immaterial whether a party has to equip itself for performance under the contract by committing an illegal act in another country. Rather, the important issue is whether performance itself necessarily involves such an illegal act.

Similarly, in *Libyan Arab Foreign Bank v Banker's Trust*,[183] the issue of foreign illegality was pleaded as a defence by Bankers Trust against a claim by the plaintiff Libyan bank for damages and recovery of over $US300m that had been frozen in its London and New York accounts by Bankers Trust acting pursuant to blocking orders issued by the US government against Libya in January of 1986.[184] Staughton J recognised the major issue to be what law was the proper law of the banking contract. Further, he observed that defendants could only be excused from performance if such performance was illegal under the proper law of the contract *or* it involved doing an act which was unlawful in the place where the contract was required to be performed.[185] Bankers Trust argued that New York law governed the contract because the account was denominated in US dollars and the parties had intended the law of New York to apply to plaintiff's London account. Accordingly, they asserted, the imposition of US economic sanctions made it illegal under the proper law of the contract for the US bank's London office to honour the Libyan plaintiff's demand for their money. The defendant US bank further argued that, even if English law applied to the contract, complying with plaintiff's demand would have 'necessarily involved' the doing of an illegal act in the United States, namely, the transfer of US dollar credits by Bankers Trust New York office on the US inter-bank payments system in violation of US blocking orders. The plaintiff argued that the proper law of the contract governing the London account was English law and that defendant was bound to discharge its obligation either in US dollars or sterling.

Staughton J ruled that the rights and obligations of the parties with respect to the London account were governed by English law (*lex loci solutionis*) and because the contract contained no express or implied term that payment must be made in US dollars, plaintiffs were entitled to demand cash payment in US dollars or sterling, or by account transfer in London, which they had done.[186] Accordingly, the plaintiff's demand for cash in London was an assertion of its right under English law and delivery by the defendant of the amounts claimed would not necessarily involve illegal action in New York. The defendant had a choice in how to discharge its obligation: they could either make payments in a manner that required illegal acts in New York in violation of US sanctions, or they could make payments in cash sterling or by account transfer in London, and thereby avoid committing any illegal acts in the United States. Consequently, the court rejected defendant's argument that the contract had become impossible or frustrated because of supervening illegality that necessarily involved illegal acts in a foreign country. Mr Justice Staughton analogised the case with *Toprak* by holding that it was not an express or implied term of the contract that defendant pay plaintiff in US dollars and therefore defendant's option to perform its obligations under the contract in a manner that would involve an illegal act under US law could not be used as a defence against performance based on foreign illegality.

The significance of the *Bankers Trust* case for the doctrine of foreign illegality and the extraterritorial application of US economic sanctions seems to be that an English court has now recognised that US economic sanctions may be extended to cover third country transactions involving third country nationals and targeted entities where payment obligations between the parties are expressly or impliedly denominated in US dollars. Moreover, even if English law is the governing law of the contract, Staughton J stated that the supervening illegality of US economic sanctions would make the contract unenforceable as a matter of English public policy, but only if the contract expressly or impliedly provided that payment obligations could only be discharged in US dollars. Based on this case, it may now be argued that the extraterritorial application of US economic sanctions may have some legal validity in the legal systems of third country states.

Conclusion

This article discussed some important issues that arise in relation to third country nationals who are involved in commercial dealing that is legal under the laws of their home country but which violate the laws of a foreign country. In determining whether the extraterritorial application of US economic sanctions will have legal validity in the legal systems of third countries, it is important to examine the origins and implications of the doctrine of foreign illegality. The doctrine can be

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traced in part to the English common law rule against trading with the enemy in the nineteenth century and to the British Trading with the Enemy legislation of the twentieth century. This principle was intimated in *Ralli Bros.* and then stated more forcefully in *Foster v Driscoll* and expanded in *Regazzoni* so that today it may now be stated that an English court will not enforce a contract, or award damages for its breach, if its performance will involve the doing of an act in a foreign and friendly state which violates the laws of that State.[187] In particular, the rule in *Regazzoni* would preclude the enforcement of an English law contract entered into by third country nationals that contemplates certain acts in the United States which violate US economic sanctions. In applying this principle, there is some basis to the argument that US economic sanctions may be effective in a legal sense by invalidating some third country contracts with targeted states and specially-designated nationals. English courts, however, will enforce payment obligations under English law contracts, even if such payment violates US economic sanctions, if the obligor has the option under the contract of paying in a currency other than US dollars, but if the contract expressly provides that payment may only be made in US dollars, the contract will be unenforceable as a matter of public policy if its performance violates US economic sanctions laws. The following chapter will discuss how the courts and governments of third country states have responded in specific instances to the extraterritorial application of US economic sanctions.

1 See Chitty On Contracts (1994 25th ed) s 16.025, pp 786-87.
2 *Soleimany v Soleimany*, [1998] 3 WLR 811.
3 *Kahler v Midland Bank Ltd*, [1950] AC 24.
4 See *Robson v Premier Oil and Pipe Line Company, Ltd*, [1915] 2 Ch 124.
5 *The Cosmopolite* [1801] 4 Ch Rob. 8.
6 See Decision of Sir Samuel Evans (President of the British Prize Court in World War I) in *The Panariellos* [1915] 84 LJ (P.) 140; and *Tingley v Muller*, [1917] 2 Ch 166, 170-01.
7 Trotter, John T., The Law of Contract Before and During War (Butterworth, London 1940) pp 26-34.
8 *Kershaw v Kelsey*, [1869] 97 American Decisions 124, 127-28.
9 Trading with the Enemy Act of 1917, *as amended*, 50 USC app §§ 1-44 (1992).
10 [1799] 1 C Rob 196 at, 198.
11 McNair, Legal Effects of Principles of Law (4th ed) at p344.
12 See *Dalmia Dairy Industries Ltd v National Bank of Pakistan* [1978] 2 Lloyd's Rep 223, at 253-54.
13 Oppenheim's International Law, vol II (7th ed) at p 321; *and* Schwarzenberger, International Law vol II (2d ed,1968) at p 93.
14 See Williston On Contracts, (3rd ed., Gaeges) Vol. 15, 3 1747A, p 116.
15 *Dalmia Dairy Industries Ltd v National Bank of Pakistan*, [1978] 2 Lloyd's Rep 223, 252-54 *.
16 See *Dalmia v of Bank of Pakistan*, [1978] 2 Lloyd's Rep 223 at 241. For example, the Indian Supreme Court, in defining its rule against trading with the enemy, refused to apply any principle based on the Royal Prerogative and instead relied on the provisions of the Constitution of India. See discussion below.
17 *Ibid* at 243-44.
18 *Dalmia v. Bank of Pakistan*, at 243–44. By contrast, some Commonwealth jurisdictions have no counterpart to these provisions, while others adopted statutes that contain identical language.
19 The Proclamation of 5th August 1914 was adopted in The Trading with the Enemy Act 1914 s 1(2).
20 See *Dalmia v Pakistan Bank*, at pp 244-45.
21 *The Anna Catharina*, [1802] 4 Ch Rob. 107.
22 Trading with the Enemy Act, 1939 ss 2 & 3 Geo IV c 89. The 1939 Act became effective on 3 September, 1939 and repealed all the Acts of 1914 to 1918 against trading with the enemy, except a portion of s 1 of the Trading with the Enemy and Export of Prohibited Goods Act, 1916 ss 6 & 7 Geo V c 52. The retained section imposed severe penalties on persons recklessly making false statements or producing false documents in order to obtain licenses to export goods.
23 See *Daimler Company, Ltd v Continental Tyre and Rubber Company (Great Britain), Ltd* [1916] 2 AC, at p 344.
24 *The Hoop* [1799] 1 Ch Rob 196, at p 199.
25 *Vandyck v Whitemore*, [1801] 1 East, 475.
26 Pitt Cobbett, Leading Cases on International Law, vol II, p 81 (3d. ed 1927).
27 See *Esposito v Bowden* , [1857] 7 E & B 763, 779.
28 SR & O, No. 1112 (1939). The Regulation further stated:
(2) payment on behalf of an enemy of any fees payable on application for a renewal of patents, or on application for the registration of designs or trade marks or the renewal of such registration in any country not being enemy territory, and the payment on behalf of an enemy to persons not being enemies of their charges and expenses, provided that payments on behalf of enemies, unless made by a person interested in or under the patent, design or trade mark, may be made only by a person out of moneys remitted by or on behalf of those enemies, or held for or on account of them, and must not be made by way of gift or advancement or loan to or on account of such enemies.
Ibid.
29 SR & O, No. 1112.
30 See William F. Trotter, The Law of Contract Before and During War (1942) pp 36-41.
31 If, however, the agency or branch was so constituted that it could have sued for the debt in its own name, payment then could only be made by obtaining a specific licence from the Trading with the Enemy Branch. All such application had to be made with the Trading with the Enemy Branch of the Treasury and/or Board of Trade located at Western Galleries, Imperial Institute, Exhibition Road, South Kensington, London, SW7.
32 The limited nature of the licence is set out in relevant part:
In pursuance of the powers conferred on me by the Aliens Restriction (No. 2) Order in Council, 1914, made on the 10th day of August under the Alien Restriction Act, 1914, I hereby permit Deutsche Bank, the Dresdner Bank, the Disconto-Gesellschaft to carry on banking business in the United Kingdom subject to the following limitations, condition, supervision, and requirement as to the deposit of money and securities: -
(1) The permission shall extend only to the completion of the transactions of a banking character entered into before the 5th day of August, 1914, so far as these transactions would in ordinary course have been carried out through or with the London establishments. The permission does not extend to any operations for the purposes of making available assets which would ordinarily be collected by, or of discharging liabilities which would ordinarily be discharged by, establishments of the banks other than the London establishments. No new transactions of any kind, save such as may be necessary or desirable for the purpose of the completion of the first-mentioned transactions, shall be entered into by or on behalf of the London

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establishments of the banks.
For full citation, see W. F. Trotter, The Law of Contract, During and After War (Butterworth,1940) pp 48-9.

33 *Cooper & Co v Deutsche Bank of Berlin* [1914] 31 TLR 179; see also, *Leader, Plunkett & Leader v Direction der Disconto-Gesellschaft*, [1914] 31 TLR 83.

34 *Milena Ship Management Company Ltd, et al* v *Newcomb, et a.* 804 F Supp 846 (ED LA. 1992).

35 The 1939 Act, *op cit* ref 22, at ss 1, 2 & 6.

36 *Ibid.*

37 *Trotter, op cit* ref 7, at pp.

38 1939 Act, *op cit* ref 23, at s 1(2).

39 [1915] 2 KB 321.

40 *Wilson v Ragosine & Co Ltd*, [1915] 31 TLR 264.

41 See discussion in Manfred Pohl, "Deutsche Bank London Agency Found 100 Years Ago", in Deutsche Bank (ed.), Studies on Economic and Monetary Problems and on Banking History, C Mainz: H Hasse, and Kohler Verlag, 233–46.

42 Jones, Geoffrey, British Multinational Banking pp 136-39 (Oxford-Clarendon Press, 1993).

43 *Schmitz v Van der Veen*, [1915] 31 TLR 214.

44 *Daimler Co Ltd*, [1916] 2 AC at 347 (LJ Parker); *see also, Tingley v Muller*, [1917] 2 Ch 144.

45 *W.L. Ingle, Ltd v Mannheim Insurance Co*, [1914] 1 KB 227 (Bailhache J).

46 The 1939 Act, at 2(i) above n. 23.

47 English courts have interpreted lithographic transfers in the definition of 'goods,' and the crime of 'obtaining' them from the enemy is not affected by the British national's entitlement to delivery of them before war. *R v Oppenheimer and Colbeck*, [1915] 2 KB 755.

48 The first case to recognise this principle with respect to the 1915 Trading With The Enemy Act was: *LA v Hetherington*, [1915] SC (J) 79.

49 See Arnold D. McWair, Legal Effects of War (2nd. ed. Cambridge: Univ. Press, 1944) Ch. 8, 192–209.

50 Cases that rely on the maxim *ex turpi causa oritur actio* but which do not concern the rule against trading with the enemy include: *Fisher v Bridges* (1854) 3 EB 642; *Geere v Mare* (1863) 2 H & C 339; *Taylor v Chester*, (1869) LR 4 QB 309; *Bigos v Bousted* [1951] 1 All ER 92.

51 See section III A2 for further discussion of defences against illegal contracts.

52 See *Upfill v Wright*, [1911] 1 KB 506. See also, *Heald v O'Connor* [1971] 1 WLR497; *Euro-Diam Ltd v Bathurst* [1990] 1 QB 1; *Saunders v Edwards* [1987] 1 WLR 1116.

53 See *Wilson v Rayson*, [1936] 1 KB 169; see also, Trading with the Enemy Act, 1939 s 9(1) (2 & 3 Geo VI c 89).

54 *Waugh v Morris*, [1873] LR 8 QB 202.

55 *Kreglinger & Co v Cohen, trading as Samuel & Rosenfeld*, [1915] 31 TLR 592.

56 *The 'Jan Frederick,'* (1804) 5 Ch Rob 128.

57 (1809) 11 East 502.

58 MacGillivray, Insurance Law (6th ed 1975) paras 537-47. If British subjects, however, are the shippers of goods to, or the consignees of goods from, the enemy country, which are carried in a neutral ship, they must pay the neutral carrier for freight, unless the goods are contraband or the neutral carrier has otherwise violated international law. 323. When the United Kingdom is neutral, it is not illegal for its nationals to trade with a port that is blockaded by a friendly third country. *The 'Helen,'* [1865] LR 1 A & E 1.

59 *Carney v Herbert* [1985] AC 301, 317A-B, PC.

60 *United City Merchants (Investments) Ltd v Royal Bank of Canada* [1983] 1 AC 168.

61 See *Kearney v Whitehaven Colliery Co*, [1893] 1 QB 700, at p 701; *Attwood v lamont*, [1920] 3 KB 571, per Lord Sterndale, MR, at p 578; *Putsnam v Taylor*, [1927] 1 KB 637, per Salter, J, at p 639.

62 *Kuenigl v Donnersmarck* [1955] 1 All ER 46 at 53, [1955] 1 QB 515 at 537 per McNair J

63 *Ibid.*

64 *Ibid* at 537.

65 *Royal Boskalis Westminster*, WV *et al*, v, Mountain *et al.*, [1997] 2 All ER 929, [1998] 2 WLR 538.

66 *Dalmia v Bank of Pakistan*, [1978] 2 Lloyd's Rep 223, 251.

67 *Horlock v Beal*,

68 [1857] 7 E & B 763 at p 781.

69 *Sovfracht v Van Udens*, [1943] AC 203.

70 See *op. cit.* ref. 55 at 778-79.

71 *Dalmia Dairy Industries, Ltd v National Bank of Pakistan*, [1978] 2 Lloyd's Rep 223.

72 *Ertel Bieber & Co v Rio Tinto Ltd, Dynamit AG (Vormals Alfred Nobel Co) v Rio Tinto Ltd, Vereinigte Koenigs v Rio Tinto Co Ltd*, [1918] AC 260, [1918-1919] All ER Rep 127 (that the rule against trading with the enemy abrogated contracts governed by German law involving UK nationals that were entered into before the outbreak of war notwithstanding provisions in the contract that revived the effectiveness of the contract after the end of war).

73 *Ibid* at 294-95.

74 *Ibid* at 230-32.

75 See *Naylor Benson & Co Ltd v Krainische Industrie*, [1918] 1 KB 331; *Ertel Bieber & Co v Rio Tinto Co Ltd*, [1918] AC 260.

76 Zinc Corporation (Ltd.) and Romains v. Skipworth and others. [1914] 31 TLR 106.

77 See Trotter, *op cit* ref 7 at pp.

78 *Zinc. Corp. Ltd v Hirsch* [1916] 1 KB 541; *Naylor, Benson & Co, Ltd v Krainische Industrie Gesellschaft* [1918] 1 KB 331.

79 *Prodexport State Co for Foreign Trade v ED & F Man Ltd* [1973] QB 389.

80 *Horlock v Beal* [1916] 1 AC 487.

81 [1863] 3 B & S, 826.

82 *Ibid* at 833.

83 *Ibid.*

84 [1920] 2 KB 287 (CA).

85 *Ibid* at 288-90. The Spanish shippers had contracted with the English charterers in London to carry goods from Calcutta to Barcelona. The shippers were to be paid £50 per ton freight in Barcelona on delivery there. After the voyage had embarked, but before the goods arrived in Barcelona, the newly-adopted Spanish law required that freight not exceed £10 per ton. When the ship arrived in Barcelona to discharge the goods at the contracted for exchange rate of fifty pounds per ton, this amount exceeded the legal limit of 875 pesetas (approx £10) per ton. The receivers paid the balance of the freight up to the point that the value reached 875 pesetas per ton, but refused to pay more citing the newly-enacted law. The ship owners then brought an action against the charterers in England claiming the excess amount that had been agreed to under the contract. *Ibid.*

86 Such rules would be recognised today in Art 7(1) of the Rome Convention. See Contracts (Applicable Law) Act 1990, *Current Law Statutes Annotated 1990*, annotations by CGJ Morse, pp 30-36.

87 See *Metropolitan Water Board v Dick, Kerr & Co* [1918] AC 119 (HL).

88 See J Collier, Conflict of Laws, (2d ed 1994) pp 212-13; see also, Dicey & Morris, Conflict of Laws, (12th ed 1993) pp 1243-47; Chesire & North, Private International Law (11th ed ?? 1994) 519.

89 See discussion in section III.

90 On 1 April 1991, the Contracts (Applicable Law) Act 1990 entered into force. See Halsbury's, Current Statutes Annotated, 1990 ch 36 and notes by CGJ Morse. The Contracts Act enacted into United Kingdom law the Convention on the Law Applicable to Contractual Obligations 1980 (Rome Convention), concluded

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between the then member states of the European Community. See D Lasok, & PA Stone, Conflict of Laws in the European Community (London, Professional Books Ltd, 1987), ch 9.

91 See discussion in Collier, at 213.

92 Law Reform (Frustrated Contracts) Act 1943 s 1.

93 [1989] 1 QB 728, 771-72.

94 *Ibid* at 732 (citing President Reagan's Executive Order dated 8 January 1986).

95 The Libyan Arab Foreign Bank was an offshore Libyan bank that was controlled by the Libyan Central Bank. The bank had a credit in its London current account with Banker's Trust of US$131m on 7 January 1986. Further, based on its agreement with Banker's Trust, the Libyan Bank also kept a call account at the New York office of Banker's Trust in which it was required to keep a minimum daily balance of $500,000. Under the agreement, at the end of each business day, Banker's Trust was required to transfer any amount above the $500,000 peg into the Libyan Bank's current account at the Banker's Trust London office. At the end of the day on 7 January 1986, one day before the blocking order was issued to freeze Libyan assets, there was a $161.4m surplus in the Libyan Bank's New York call account, which Banker's Trust was obliged to transfer that day into the Libyan Bank's London account. Banker's Trust failed to do this, even before the sanctions order was issued. After the blocking order went into effect on 8 January 1986, Banker's Trust responded to the Libyan's demand for return of its money by arguing that it could not release the funds because to do so would require inter-bank transfers in US dollars through the New York Clearing House Inter-Bank Payments System (CHIPS) and that because of the freeze order it was illegal to transfer the credits in US$ through the New York clearing system. Banker's Trust essentially argued that because of supervening illegality, it could not perform its obligations under the contract. See *Ibid* at pp 730-34.

96 *Ibid* at p 772.

97 *Ibid*. Moreover, Mr Justice Staughton found that plaintiff's frustration claim based on s 1 of the Act should be denied because the Libyan bank had not 'paid' money into their account 'in pursuance of the contract' because the deposit had been voluntary and not part of a contractual obligation. *Ibid*.

98 Fentiman, Richard, Foreign Law in English Courts (Oxford, 1998) p 108.

99 *De Wutz v Hendricks*, (1824) 2 Bing. 314; *Foster v Driscoll* [1929] 1 KB 470 (C.A.); *Regazzoni v KC Sethia, Ltd* [1958] AC 301; R. Jennings [1956] CLJ 41; FA Mann (1956) 19 MLR 523; and Reynolds (1992) LQR 117(????).

100 Chesire and North, Private International Law (12th ed 1992) 538-540.

101 (1734) Cas. & Hard. 85, 89, 95 Eng. Rep 53, 125.

102 *De Wutz v Hendricks* (1824) 2 Bing. 314. In this case, plaintiff deposited certain papers as security with defendant for a loan to raise funds to support Greek rebels in an uprising against the Turkish government. When the defendant failed to provide the proceeds for the loan, the plaintiff filed suit seeking recovery of the papers. The court refused to enforce the action because the subject matter of the action had an illegal purpose, which was the overthrow of a friendly government.

103 *British & Foreign Marine Insurance v Samuel Sanday & Co* [1916] 1 AC 650, 672.

104 *Regazzoni*, see above n 146, at p 290-91 (Lord Simonds).

105 *Regazzoni*, above n 142; *Foster v Driscoll*, above n 142..

106 See authorities in above n 142.

107 *Lemenda Trading Co, Ltd v African Middle East Petroleum Co, Ltd*, [1988] QB 488, 461.

108 *Ibid* at 461.

109 *Ibid*.

110 See *Foster v Driscoll, Lindsay v Attfield, Lindsay v Driscoll*, [1929] 1 KB 470, [1928] All ER Rep 130.

111 *Ibid* at 521-22.

112 *Ibid* at 510.

113 Indeed, Lawrence LJ stated a broader principle that would later be adopted in *Regazzoni* that an English court will not enforce an English law contract if 'a partnership formed for the main purpose of deriving profit from the commission of a criminal offence in a foreign and friendly country is illegal'. *Foster v Driscoll*, see above n 157, at 510.

114 [1957] 3 All ER 286.

115 *Ibid* at 509-511. Courts have interpreted the term 'involves' as meaning 'involves of necessity' or 'requires' *Kleinwort, Son & Co v Ungarische Baumwolle Industrie Aktiengesellschaft*, [1939] 2 KB 678, 687.

116 See above n 132.

117 *Regazzoni*, at 288-90.

118 *Ibid*, at 293 (Lord Reid).

119 *Ibid* at 294.

120 *Ibid* at 296. *(author's emphasis)*

121 Mann, 'Illegality and the Conflict of Laws' (1958) 21 MLR 130-37.

122 McNair, *Legal Effects of War* (?? ed , 19??) p 10.?

123 See Schnitzer, *Handbuch des Internationalen Privatrechts (get modern ed 1950 or any German private intl law book in english)* , ii, p 684. See FN 25 in Mann.

124 Mann, see above n. 168 at p 136.

125 Mann, F.A., The Legal Aspect of Money 10th ed? 1992) at try 362. See also discussion below on US and Canadian doctrine of foreign illegality.

126 *Royal Boskalis International BV v Mountain et al.*, [1997] 2 All E.R. 929, 937?; [1998] 2 WLR 538, 546.

127 [1998] 3 WLR 811.

128 See *infra* n 146.

129 *Buchanan v McVey* [1954] I.R. 89; [1955] AC 516, 523; *Rousseau v Manufacturers Life Ins. Co* [1963] 2 QB 352, 376-77.

130 *Euro-Diam Ltd v Bathurst* [1990] 1 QB 40 (C.A.).

131 Dicey & Morris, The Conflict of Laws at 1282.

132 *Regazzoni*, see above n. 146, at 327, *per* Lord Keith; see also, Lord Somervill at p 330; *Attorney General of New Zealand* v *Ortiz* [1984] AC 1.

133 *Regazzoni v KC Sethia* (1944) Ltd [1958] AC 301, per Viscount Simonds, at p 317, per Lord Reid, at p 323; Dicey & Morris, The Conflict of Laws, 12th ed (1993), vol. 2, pp 1282-83, and Cheshire and North, above n. 143 at p 504.

134 *Foster v Driscoll, Lindsay v Attfield, Lindsay v Driscoll* [1929] 1 KB 470, [1928] All ER 130.

135 [1920] 2 KB 287 (C.A.).

136 *Ibid*.

137 *Ibid* at p 301.

138 *Ibid* at pp 304 & 555.

139 See *Ralli Bros. v Cia Naviera Sota y Aznar* [1920] 2 KB 287, [1920] All ER Rep 427; *Regazzoni v KC Sethia* (1944) Ltd [1957] 3 All ER 286, [1958] AC 301.

140 See R Fentiman, Foreign Law in English Courts (Oxford 1998) 109. See also, J Collier above n.134 at p 212-13.

141 [1998] 3 WLR 811.

142 Dicey & Morris see above n. at 1282.

143 Woolf, ? §§ 158-161. See also, Dicey & Morris, Conflict of Laws at 1277.

144 See *Vervaeke v Smith*, [1983] 1 AC 145, 163. Indeed, there is scholarly authority for the view that where the contract involves no illegality but instead offends against a head of English public policy, courts should exercise care in determining whether domestic policy demands non-enforcement of a contract with substantial, or even exclusively, foreign contacts and is valid

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under its foreign governing law. See Chitty, Contracts § 16-027 pp 787-88. (??ed. 1994).

145 See Dicey & Morris, Conflict of Laws at 1277-78.

146 Dicey & Morris state that 'Manifestly' means 'evidently or obviously' and that there is no reason to suppose that there is any important difference between this test and the manner in which English public policy has been applied to foreign contracts. *ibid* at 1278. Most scholars agree that there is no significant difference between Article 16 and the pre-existing manner in which English public policy has applied to foreign contracts.

147 *Ibid* at p 1278. Moreover, the term 'Manifestly' means evidently or obviously, and Dicey states that there is 'no significant difference between this test' and the way in which public policy has been applied under the pre-existing English law.

148 As a general matter, English courts have been more reluctant to invoke public policy in cases involving a foreign element than when a purely local legal issue is involved. *Vervaeke v Smith* [1983] 1 AC 145, 164.

149 *Loucks v Standard Oil Co*, 120 N.E. 198, 202 (NY Ct. App 1918)(Cardozo opinion stating that courts will not refuse to enforce or recognise a foreign right unless it would 'violate some fundamental principle of justice').

150 Chitty on Contracts, see above n. 93 §30-109..

151 Dicey & Morris, Conflict of Laws at 1279.

152 *Kaufman v Gerson* [1904] 1 KB 591, 598, 600 (CA). This is so even though the contract may have no connections with England other than that England was the forum for the claim under the contract. As Lord Halsbury stated in *Re Missouri Steamship Co*, 'where a contract is void on the ground of immorality . . . then the contract would be void all over the world, and no civilised country would be called on to enforce it.' (1889) 42 Ch D. 321, 336, *per* Lord Halsbury LC

153 See Lloyd, *Public* Policy, pp 72-79. Royal *Boskalis*, see above n. [1997] 2 All ER 929, 941-44 (refusing to recognise a contract governed by Iraqi law that compelled foreign companies to relinquish earlier contractual rights under threat of imprisonment of employees was contrary to general principles of law and international morality). But *cf.* Dimskal *Shipping Co S.A. v International Transport Workers Federation* [1992] 2 AC 152, 168 (holding that a contract affected by economic duress depended on English law as the governing law).

154 Guliano-LaGarde, p 38.

155 *Oppenheimer v Cattermole* [1976] AC 249; see also, *The Playa Larga* [1983] 2 Lloyd's Rep 171, 194 (CA).

156 Dicey & Morris, at p 1278.

157 *Lemenda Trading Co Ltd v African Middle East Petroleum Co Ltd* [1988] QB 448, 459; *Kaufman v Gerson* [1904] 1 KB 591 (CA).

158 *Boissevain v Weil*, [1950] AC 327.

159 Dicey & Morris, at p 1278.

160 *Dynamit A.G. v Rio Tinto Co Ltd*, [1918] AC 292, 293-94, 298-99; see also, *Schering Ltd v Stockholms Enskilda Bank Atkiebolag*, [19946] AC 219.

161 Dicey & Morris, at p 1279; *cf. Trendtex Trading Corp. v Credit Suisse* [1982] AC 679.

162 See *Sayers v International Drilling Co*, [1971] 1 WLR 1176 (where English court enforced foreign contract that violated regulatory statute). *Cf. Leroux v Brown* (1852) 12 C.B. 801.

163 See Contracts (Applicable Law) Act 1990, s 7(2). See also, art 7(2) of Directive 88/357, on non-life insurance; art 4(4) of Directive 90/169, on life insurance; and art. 17 of the Hague Convention (1985) on the Law Applicable to Contracts for the International sale of Goods.

164 *Re Fried Krupp AG* [1917] 2 Ch 188.

165 *Ibid* at 190 (citing *Wolff v Oxholm* (1817) 6 M & S 92, 105 ER 1177.

166 *The Playa Larga* [1983] 2 Lloyd's Rep 171, 190 (C.A.).

167 *Williams & Humbert Ltd* v *W. & H. Trade Marks (Jersey) Ltd* [1986] AC 368, 428.

168 See discussion *infra* at Chapter Eight discussing the responses of national legal systems.

169 *Regazzoni*, see above n. 146, 2 QB at 522.

170 See discussion in Chapter 8 of European Union Regulation 96/2271.

171 [1950] AC 24.

172 In 1938, the plaintiff, who was at the time a Czech national residing in Prague, became a customer of the Zivnostenska bank (Z Bank). Shortly thereafter, the bank informed him that, by order of his former bankers, they were crediting him with 800 shares in a Canadian company in a deposit account they had opened for him. The plaintiff had purchased the shares a few years earlier on the London Stock Exchange and the share certificates were noted as 'domiciled' in London. *Ibid* at 25. The Z Bank entered a bailment with Midlands Bank to keep custody of the shares in its London office. After the Nazi occupation of Prague in April of 1939, the plaintiff was compelled by German authorities to transfer his rights with regard to the shares from the Z Bank to the German-controlled Bohemian Bank, which assumed contractual rights of bailor over the shares. *Ibid* at p 26.

173 *Ibid* at p 28. Plaintiff's solicitors had contacted the bailor Czech bank, the Bohemian Bank, to seek approval for the release of the shares, but the bank refused because it would be illegal under Czech law to do so without permission of the Czech National bank, which denied plaintiff's request as well because of the post-war financial crisis. *Ibid.*

174 *Ibid* at p 31.

175 *Ibid* at p 30.

176 Dicey and Morris, Conflict of Laws at p (at pp. 812-13)

177 *Kahler* above n 248, at p 32-33. The Lords decided that Czech law was the proper law notwithstanding the fact that plaintiff's previous banker, the Zivnostenska bank, had kept the securities on deposit with Midland in its London office and that the securities had remained there after the rights to their possession was transferred to the Bohemian Bank of Prague in 1940 where they remained until plaintiff filed its action.

178 *Ibid.* At the time the contract was made and at all relevant times thereafter, Czech law had included a foreign exchange law the content of which had essentially remained the same as that which prevailed at the date plaintiff issued its writ.

179 [1939] 2 KB 678.

180 *Toprak Mahsulleri Ofisi v Finagrain Compagnie Commerciale Agricole et Financiere S.A.* [1979] 2 Lloyd's Rep 98.

181 *Ibid* at 114.

182 *Ibid.*

183 [1988] 1 QB 728. See also, *Libyan Arab Foreign Bank v Manufacturers Hanover Trust (No.2)*, [1989] 1 Lloyd's Rep 608.

184 *Ibid* 1 QB at 732. President Reagan had issued the order to freeze 'all property and interests in property of the Government of Libya, its agencies, . . and controlled entities,' that were under the control of US persons or US-controlled foreign entities.

185 *Ibid* at 743 citing *Euro-Diam Ltd v Bathurst*, [1987] 2 WLR 1368, 1385.

186 *Ibid* at pp 731-33.

187 *Foster v Driscoll* [1929] 1 KB 470 (contract to evade US prohibition laws); *Regazzoni v KC Sethia* Ltd [1958] AC 301 (HL) (contract to supply jute to South Africa in breach of the law of India)..