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Case No: CL-2001-000289 and CL-2001-000290

IN THE HIGH COURT OF JUSTICE
QUEEN'S BENCH DIVISION
BUSINESS & PROPERTY COURTS
COMMERCIAL COURT

Royal Courts of Justice
7 Rolls Building, Fetter Lane,
London EC4A 1NL

Date: 24/07/2019

Before:

MR. JUSTICE PHILLIPS

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Between:

MINISTRY OF DEFENCE & SUPPORT FOR ARMED FORCES OF THE ISLAMIC REPUBLIC OF IRAN	**Claimant**
- and -	
INTERNATIONAL MILITARY SERVICES LIMITED	**Defendant**

- -
- -

Andrew Fletcher QC and **David Davies** (instructed by **Stephenson Harwood LLP**) for the Claimant
Joe Smouha QC and **Tom Ford** (instructed by **Clifford Chance LLP**) for the Defendant

Hearing dates: 21 and 22 May 2019

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Approved Judgment

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MR. JUSTICE PHILLIPS:

1. By application notice dated 11 September 2012 ("the 2012 Application") the claimant ("MODSAF") seeks to enforce two ICC arbitration awards ("the Awards") against the defendant ("IMS") by way of the entry of judgment and a declaration that sums currently held in court as security for the Awards are held for MODSAF's benefit.

2. However, it is common ground that, due to EU santions against Iran, IMS cannot currently pay the Awards and the court cannot enforce payment of the sums awarded (whether or not, as MODSAF contends, judgment can nevertheless be entered against IMS).

3. It is important to emphasise, not least because of press interest and the intervention of The Times newspaper (resulting in my decision to order that the hearing and this judgment be public, the reasons for which I gave in an earlier judgment), that the hearing before me was concerned solely with the quantum of the Awards which may, at some future time, be paid or otherwise enforced. The principal issue debated at the hearing and determined below is whether IMS is liable to interest on the Awards during the period during which it has not been permitted to satisfy the Awards because EU sanctions have been in force.

Background

4. MODSAF is the Iranian Ministry of Defence. IMS is an English company, all but one of its shares being owned by the UK Ministry of Defence, that one share being owned by HM Treasury.

5. The underlying dispute between the parties arose out of two contracts concluded in the 1970s pursuant to which IMS agreed to supply Chieftain tanks and Armoured Recovery Vehicles to MODSAF. The contracts were terminated on 6 February 1979 following the Iranian revolution, leaving disputes between the parties as to the balances payable. This led to two related ICC arbitrations, one commenced by MODSAF in 1990 and the other by IMS in 1996. On 2 May 2001 the ICC tribunal rendered final awards in both arbitrations, the Awards referred to above.

6. In the dispositive part of its Award on MODSAF's claim ("the 7071 Award"), the tribunal found:

> "*(1) That [IMS] is liable to pay to [MODSAF] the sum of £Stg. 140,599,570 in respect of termination of the P4030 and the ARVs Contracts;*
>
> *(2) That interest on the said sum should be paid from 28 July 1984 to the date of payment at the LIBOR rate +0.5%;*
>
> *(3) That [IMS] should pay [MODSAF] US$6,255,404 in respect of its costs in this arbitration.*

> *(4) The total amount of the costs of arbitration fixed by the ICC is US $ 1,800,000. Therefore, [IMS] is responsible for an amount of US $ 1,143,750 in respect of the arbitration costs and expenses and [MODSAF] is responsible for the remaining amount of US$656,250.*"

7. The ICC tribunal dismissed IMS's claim ("the 9268 Award") for the same reasons as it gave in the 7071 Award. In the 9268 Award the tribunal also ordered IMS to pay $3,127,701 in respect of MODSAF's costs.

8. By without notice arbitration applications dated 30 July 2001, MODSAF applied to this court pursuant to section 101 of the Arbitration Act 1996 ("the Act") to enforce the Awards in the same manner as a judgment of the High Court. On 31 July 2001 Morison J granted leave to enforce, but subject to the usual provision that the Awards were not to be enforced until after any application to set aside the orders was finally disposed of.

9. On 16 August 2001 IMS issued applications to set aside or, alternatively, to adjourn MODSAF's enforcement proceedings, in particular in view of IMS' challenge to the Awards before the Dutch courts. By a consent order dated 5 December 2002, MODSAF's enforcement proceedings were indeed adjourned pending the final resolution of IMS's challenge in the Netherlands. The consent order provided that the adjournment was conditional on IMS paying £382,500,000 into court by way of security in respect of any sums that might ultimately be determined to be due from it to MODSAF pursuant to the Awards. On 18 December 2002 IMS provided the required security. That sum has now increased, by te accrual of interest, to just over £500,000,000.

10. On 21 December 2006 the Court of Appeal in The Hague partially set aside the 7071 Award by reducing IMS's liability to MODSAF to £127,651,823. In all other respects the Awards were upheld. On 24 April 2009 the Supreme Court of Netherlands dismissed an appeal from the Court of Appeal's decision.

11. By then MODSAF had been added to the list of entities subject to sanctions imposed against Iran by EU Council Regulation 423/2007 (presently Regulation 267/2012 ('Regulation 267')). The sanctions against MODSAF had taken effect on 24 June 2008. As a result, it is common ground that the sums due under the Awards cannot presently be paid to MODSAF.

12. Nevertheless, MODSAF's position was (and remains) that there is no impediment to the English Court entering judgment in terms of the Awards pursuant to the enforcement regime contained in sections 100-104 of the Act. Accordingly, on 11 September 2012, MODSAF issued the 2012 Application seeking the dismissal of the Defendants' applications to set aside, judgment in terms of the Awards and a declaration that the funds held by the Court Funds Office are held for the benefit of MODSAF.

13. The 2012 Application has taken an unusually convoluted procedural course. It was initially listed to be heard on 23-24 January 2013 but adjourned five times. Meanwhile, on 16 January 2016, the Central Bank of Iran ('the CBI') was removed from the list of sanctioned entities under Regulation 267. In the light of this development MODSAF applied for a further adjournment. This was intended to allow MODSAF time to make

an application to the Office of Financial Sanctions Implementation of HM Treasury ('OFSI') for a licence under Article 25(a) of Regulation 267 that, MODSAF says, will facilitate payment of the sums due under the Awards to the CBI ('the Licence Application'). MODSAF's position is that, if its Licence Application is successful, it could, following the entry of judgment, invite the court to direct that the sums due under the Awards be paid to the CBI from the funds held in the Court Funds Office. On 2 December 2016, Blair J ordered that the hearing of the 2012 Application be re-listed for hearing on 4-6 October 2017 and directed that MODSAF pursue the Licence Application with all due diligence. MODSAF made the Licence Application on 14 March 2017. However, a decision on the application had not become available by October 2017. Accordingly, the hearing set for 4-6 October 2017 was not effective and was adjourned three further times until it came before Moulder J on 1 May 2019.

14. At the 1 May hearing Moulder J determined that the following issues should be determined prior to the full hearing of the 2012 Application:

1. Subject to whether in due course upon the hearing of the 2012 Application MODSAF is entitled to have leave to enforce the Awards and to have judgment entered in terms of the Awards:

i) What are the "terms" of the Awards for the purpose of s 101(2) and (3) of the Arbitration Act 1996 ("**the terms of the Awards issue**")?

ii) Should the Court refuse enforcement of any post-award interest element of the Awards pursuant to Articles 42 and/or Article 38 of the Regulation 267 and/or s. 103(3) of the 1996 Act in relation to the period since MODSAF became a designated entity (it being agreed that IMS is and has been unable to make payment to MODSAF since MODSAF was designated as a specific target of EU sanctions on 24 June 2008) ("**the interest during the sanctions period issue**")?

iii) Is MODSAF entitled to post-award, pre-judgment interest on costs and if so at what rate ("**the interest on costs issue**")?

iv) What would be the relevant quantum for the purposes of the 2012 Application (when determined) taking into account (a) the proper calculation of interest in conformity with the answers to the issues at (ii) and (iii) above and (b) giving credit for amounts previously paid ("**the total quantum calculations issue**")?

2. In the light of the determination of the issues above, what balance of its funds currently held in the Court Funds Office should now be returned to IMS?

15. Molder J further gave directions for those issues to be determined at the hearing before me on 21 and 22 May 2019.

16. MODSAF has in the event abandoned its claim for post-award, pre-judgment interest on costs.

17. Moreover, I do not consider that it would be appropriate to determine the terms of the Awards issue at this stage in circumstances where the prior question of whether the Awards are enforceable in England remains to be decided. In my judgment, it would be

more appropriate for the terms of the Awards to be considered alongside the question of whether the Awards are enforceable. I raised this point with the parties during oral argument and both parties confirmed that they were content with this course.

18. That leaves the interest during the sanctions period issue, to which I will now turn. Determination of that issue will enable the parties to agree the total quantum issue and, correspondingly, the balance of the funds in court which can be returned to IMS, it being accepted that the sums in court exceed IMS' total liability in any event, not least because of the revision to the principal amount of the sum awarded.

The interest during the sanctions period issue

19. As set out in paragraph 6 above, sub-paragraph (2) of the dispositive part of the 7071 Award (as varied) provides that IMS should pay interest to MODSAF on the sum of £127,651,823 from 28 July 1984 to the date of payment at LIBOR +0.5%. MODSAF wishes to enforce this component of the 7071 Award in full. IMS contends that MODSAF is not entitled to enforce the interest component of the 7071 Award insofar as it relates to the period during which MODSAF was subject to the sanctions imposed by Regulation 267 namely, from 24 June 2008 onwards. In substance this is because, during the sanctions period, IMS was prevented from making payments to MODSAF to discharge its liability pursuant to the Awards.

20. For the purposes of the hearing before me, it was common ground between the parties that, in the period during which MODSAF was a sanctioned entity, IMS has been (and is) unable to make payments to MODSAF in respect of the sums due under the Awards. Indeed, in her formulation of this issue Moulder J noted that the parties were "*agreed that IMS is and has been unable to make payment to MODSAF since MODSAF was designated as a specific target of EU sanctions on 24 June 2008*".

21. As mentioned above, MODSAF's position is that the de-listing of the CBI as a sanctioned entity under Regulation 267 opens up a licensing route pursuant to which it could procure that IMS discharge its liability under the Awards by making payments to the CBI. If MODSAF's Licence Application is successful, it will wish to invite the court to make an order directing the payment of the sums due under the Awards to the CBI from the funds in the Court Funds Office. IMS does not accept that this licensing route is available to MODSAF. The parties have not invited me to decide whether the licensing route is indeed open to MODSAF, not least because the outcome of its Licence Application remains unknown. In this judgment, therefore, I will proceed on the basis that the sanctions regime prevented (and prevents) IMS from making payments to MODSAF to satisfy the Awards.

22. Based on the premise that the sanctions regime prevented (and prevents) IMS from making payments to discharge its liability to MODSAF under the Awards, IMS argues that MODSAF is not entitled to enforce the interest component of the 7071 Award in respect of the period during which MODSAF was a sanctioned entity. In support of that contention, IMS relies on Articles 38 and 42 of Regulation 267.

23. Articles 38 and 42 appear in Chapter VII of Regulation 267 which is entitled 'General and Final Provisions'.

24. Article 38 provides that:

> "*1. No claims in connection with any contract or transaction the performance of which has been affected, directly or indirectly, in whole or in part, by the measures imposed under this Regulation, including claims for indemnity or any other claim of this type, such as a claim for compensation or a claim under a guarantee, notably a claim for extension or payment of a bond, guarantee or indemnity, particularly a financial guarantee or financial indemnity, of whatever form, shall be satisfied, if they are made by:*
>
> *(a) designated persons, entities or bodies listed in Annexes VIII and IX;*
>
> *(b) any other Iranian person, entity or body, including the Iranian government;*
>
> *(c) any person, entity or body acting through or on behalf of one of the persons, entities or bodies referred to in points (a) and (b).*
>
> *2. The performance of a contract or transaction shall be regarded as having been affected by the measures imposed under this Regulation where the existence or content of the claim results directly or indirectly from those measures.*
>
> *3. In any proceedings for the enforcement of a claim, the onus of proving that satisfying the claim is not prohibited by paragraph 1 shall be on the person seeking the enforcement of that claim.*
>
> …"

25. Article 42 provides that:

> "*1. The freezing of funds and economic resources or the refusal to make funds or economic resources available, carried out in good faith on the basis that such action is in accordance with this Regulation, shall not give rise to liability of any kind on the part of the natural or legal person, entity or body implementing it, or its directors or employees, unless it is proved that the funds and economic resources were frozen or withheld as a result of negligence.*"

26. In order to understand the context of Articles 38 and 42, it is necessary to consider, in particular, two other provisions of Regulation 267. The first is Article 23, which appears in Chapter IV under the title 'Freezing of Funds and Economic Resources'. In one sense, Article 23 is the centrepiece of the sanctions regime. It has the effect of freezing all funds and economic resources belonging to certain persons, bodies and entities related to Iran. Thus, Article 23(1) provides that:

> "*All funds and economic resources belonging to, owned, held or controlled by the persons, entities and bodies listed in Annex VIII shall be frozen…*"

27. In identical language, Article 23(2) provides that all funds and economic resources belonging to persons, bodies and entities listed in Annex IX of Regulation 267 shall be frozen. Then, Article 23(3) states as follows:

> "*No funds or economic resources shall be made available, directly or indirectly, to or for the benefit of the natural or legal persons, entities or bodies listed in Annexes VIII and IX*."

28. Secondly, Article 29 of Regulation 267 clarifies that Article 23(3) does not have the effect of preventing the payment of sums into a frozen account so long as those additional funds also remain frozen. Article 29(1) provides that:

> "*Article 23(3) shall not prevent financial or credit institutions from crediting frozen accounts where they receive funds transferred onto the account of a listed natural or legal person, entity or body, provided that any additions to such accounts shall also be frozen…*"

29. Then, Article 29(2) goes on to state that:

> "*Article 23(3) shall not apply to the addition to frozen accounts of:*
>
> *(a) interest or other earnings on those accounts; or*
>
> *(b) …*
>
> *provided that any such interest or other earnings and payments are frozen in accordance with Article 23(1) or (2).*"

30. In the formulation of the issues by Moulder J and in IMS' written submissions for this hearing, apart from the provisions of Regulation 267, reference was also made to section 103(3) of the Arbitration Act 1996. Section 103(3) provides that:

> "*Recognition or enforcement of the award may also be refused if the award is in respect of a matter which is not capable of settlement by arbitration, or if it would be contrary to public policy to recognise or enforce the award.*"

31. However, it became apparent in the course of the oral argument that section 103(3) was not an independent ground upon which IMS sought to resist enforcement of the interest component of the 7071 Award. Therefore, IMS's contention that MODSAF should not be allowed to enforce the 7071 Award insofar as it related to interest during the sanctions period turns solely on Articles 38 and 42, it being contrary to public policy within the meaning of section 103(3) of the Act to recognise or enforce the Awards if Articles 38 or 42 prevent the same.

32. In its written submissions MODSAF relied upon a number of authorities for the proposition that, as a matter of English law, interest will continue to accrue in favour of a creditor even if, for a particular period, it was legally impossible for the debtor to discharge the debt, in particular, *The Berwickshire (No 2)* [1950] P 204, *Mamodoil-Jetoil Greek Petroleum Company SA v Okta Crude Oil Refinery AD* [2003] 1 Lloyd's

Rep 42, *Biedermann v Allhausen* (1921) 37 TLR 662, *Ledeboter v Hibbert* [1947] KB 964 and *McGregor on Damages* (20th edition, 2017) at [19-082], [30-22]. However, during his oral submissions, Mr Fletcher QC, for MODSAF conceded that these authorities were unlikely to assist me in deciding the interest during the sanctions period issue.

33. On that basis, the only question for me to decide is whether Articles 38 and 42, properly construed, prevent MODSAF from enforcing the interest component of the 7071 Award in respect of the sanctions period. Before I consider that question in more detail, though, it is necessary to examine the principles by reference to which Articles 38 and 42 fall to be interpreted.

Interpretation of EU Instruments

34. The principles by reference to which EU instruments are to be interpreted have been considered numerous times both by the Court of Justice of the European Union and by the English Courts. I will not attempt an exhaustive restatement of all the principles of construction. It will suffice for me to state the relevant rules relatively briefly.

35. In general, the authorities emphasise that both the language and the purpose of EU instruments are significant. Thus, in his opinion in *Möllendorf and Möllendorf-Niehuus* (Case C-117/06), Advocate General Mengozzi observed at [68] that "*for the purposes of interpreting a provision of Community law account must be taken not only of the letter of the provision but also of its context and of the aims pursued by the legislation of which it forms part*". In *Möllendorf,* the European Court interpreted Council Regulation (EC) No 881/2002 which imposed restrictive measures against certain persons and entities associated with Usama bin Laden, the Al-Qaida network and the Taliban. In doing so, the Court took into account both the wording and the purpose of the UN Security Council Resolution 1390 (2002), which Regulation 881/2002 was designed to implement (see [54] in particular).

36. Although language and purpose are both important aids to construction, the authorities suggest that the English and European methods of interpretation may approach these indicia slightly differently: see *Bennion on Statutory Interpretation* (7th edition, 2019) 748-750. Lord Steyn put the point in the following way in his speech in *Shanning Ltd v Lloyds TSB Bank plc* [2001] 1 WLR 1462 at [24]:

> "*There is an illuminating discussion in* Cross, Statutory Interpretation, *3rd ed (1995), pp 105-112 of the correct approach to the construction of instruments of the European community such as the regulation in question. The following general guide provided by Judge Kutscher, a former member of the European Court of Justice, is cited by* Cross, *at p 107:*
>
> *"You have to start with the wording (ordinary or special meaning). The court can take into account the subjective intention of the legislature and the function of a rule at the time it was adopted. The provision has to be interpreted in its context and having regard to its schematic relationship with other provisions in such a way that it has a reasonable and effective meaning. The rule must be understood in connexion with the*

> *economic and social situation in which it is to take effect. Its purpose, either considered separately or within the system of rules of which it is a part, may be taken into consideration."*
>
> *Cross points out that of the four methods of interpretation—literal, historical, schematic and teleological—the first is the least important and the last the most important.* Cross *makes two important comments on the doctrine of teleological or purposive construction. First, in agreement with* Bennion, Statutory Interpretation, *2nd ed (1992), section 311,* Cross *states that the British doctrine of purposive construction is more literalist than the European variety, and permits a strained construction only in comparatively rare cases. Judges need to take account of this difference. Secondly,* Cross *points out that a purposive construction may yield either an expansive or restrictive interpretation. It follows that Regulation No 3541/92 ought to be interpreted in the light of the purpose of its provisions, read as a coherent whole, and viewed against the economic and commercial context in which the regulation was adopted.*" (emphasis added)

37. From this passage, and from the decision of the CJEU in *Möllendorf*, it appears that the difference between the European and English approaches to construction is no more than a difference in emphasis. Both approaches consider the language and the purpose of a legislative provision to be relevant. While the English approach places relatively more weight on language, the European approach leans in favour of giving effect to the purpose that the provision (or the instrument of which it forms a part) is intended to achieve. This is not to say that language is irrelevant under the European approach. Indeed, Judge Kutscher's observations suggest that, even under the European approach, one would start the process of interpretation by paying attention to the text of the relevant provision.

38. The principle of proportionality is another well-established rule of EU law that informs the interpretation of EU legislation. Proportionality requires that EU instruments must be interpreted such that the measures sought to be implemented by them are appropriate for attaining the legitimate objectives pursued by the instrument and do not go beyond what is necessary to achieve those objectives: *Rosneft & Others v Council & Others* (Case T-715/14) at [202]. In this regard, it is necessary to have particular regard to whether the interpretation of EU instruments affects any of the fundamental rights guaranteed under EU law. If so, the court must adopt an interpretation that avoids disproportionate infringement of such rights: *R v R* [2016] Fam 153 at [28] (Arden LJ), *Möllendorf* at [79].

39. In the context of those principles, I turn to consider Articles 38 and 42.

Article 38

40. As noted earlier, Article 38(1) provides that:

> "*1. No claims in connection with any contract or transaction the performance of which has been affected, directly or indirectly,*

> *in whole or in part, by the measures imposed under this Regulation, including claims for indemnity or any other claim of this type, such as a claim for compensation or a claim under a guarantee, notably a claim for extension or payment of a bond, guarantee or indemnity, particularly a financial guarantee or financial indemnity, of whatever form, shall be satisfied, if they are made by:*
>
> *(a) designated persons, entities or bodies listed in Annexes VIII and IX;*
>
> *(b) any other Iranian person, entity or body, including the Iranian government;*
>
> *(c) any person, entity or body acting through or on behalf of one of the persons, entities or bodies referred to in points (a) and (b).*"

41. IMS argues that this provision precludes MODSAF from enforcing the interest component of the 7071 Award insofar as it relates to the period during which IMS was precluded from making payments to MODSAF by virtue of MODSAF's status as a sanctioned entity. In assessing that contention, I will start by analysing the language of Article 38 and then consider its purpose. That does not mean that I consider the language of Article 38 to be more significant than its purpose. Indeed, it will be apparent from what I say below that, in my view, the language and purpose of Article 38 are not at odds with each other; rather, they reinforce each other.

42. As Mr Smouha QC, for IMS, pointed out, the language of Article 38(1) consists of five material components: (i) no claims (ii) in connection with any contract or transaction (iii) the performance of which has been affected, directly or indirectly, in whole or in part, by the measures imposed under this Regulation (iv) shall be satisfied (v) if they are made by designated persons, entities or bodies listed in Annexes VIII and IX.

43. As to the first element, the term 'claim' is defined in Article 1(c) of Regulation 267 as:

> "*any claim, whether asserted by legal proceedings or not, made before or after the date of entry into force of this Regulation, under or in connection with a contract or transaction, and includes in particular:*
>
> *…*
>
> *(v) a claim for the recognition or enforcement, including by the procedure of exequatur, of a judgment, an arbitration award or an equivalent decision, wherever made or given.*"

44. The relevant 'claim' for the present purposes is MODSAF's Application for judgment to be entered in terms of the Awards. Plainly, that is "*a claim for the recognition or enforcement… of… an arbitration award*" and, therefore, falls within the scope of Article 1(c). It follows, in my view, that IMS can satisfy the first element of Article 38.

45. Mr Fletcher argued that the definition of "*claim*" in Article 1(c) was not intended to apply to the construction of Article 38(1). To substantiate that contention, he referred to Regulation (EC) 1110/2008, an earlier version of Regulation 267. It was by Regulation 1110 that a provision corresponding to Article 38 (then Article 12a) was inserted for the first time into the EU sanctions regime against Iran. Mr Fletcher pointed out that the definition of "*claim*" in Regulation 1110 was narrower than the definition that is presently contained in Regulation 267. In particular, Regulation 1110 did not contain a provision corresponding to sub-paragraph (v) of Article 1(c). The present expansive definition of "*claim*" was first introduced by Article 1(s) of Regulation 961/2010.

46. Mr Fletcher submitted that the reason why Regulation 961 expanded the scope of the definition of "*claim*" was to increase the scope of application of a specific derogation from the sanctions regime that was contained in Article 17 of Regulation 961 (now, Article 25 of Regulation 267). In broad terms, Article 17 provided that, by way of derogation from the sanctions regime, the competent authorities of the Member States may authorise the release of certain frozen funds if, *inter alia*, the funds are subject to a pre-existing judicial, administrative or arbitral lien and they will be used exclusively to satisfy claims secured by such a lien. On this basis, Mr Fletcher submitted that the purpose of expanding the scope of the definition of "*claim*" was to increase the scope of a derogation from the sanctions regime, not to expand the scope of the sanctions. Therefore, he argued, the broad definition of "*claim*" in Article 1(c)(v) must not be used to interpret Article 38. To do so would run counter to the purpose for which that definition of "*claim*" was introduced.

47. I am unable to accept this submission for two reasons. First, it is far from clear that the reason for introducing the broader definition of "*claim*" in Regulation 961 was particularly concerned with the scope of the derogation contained in Article 17. Plainly, as with any other provision in the Regulation that employs the term "*claim*", the expanded definition would have had an impact on Article 17. Beyond that, there is no reason to think that the amendment to the definition was specifically concerned with the scope of Article 17. This is especially so since the derogation contained in Article 17 was not introduced for the first time by Regulation 961. Regulation 423/2007 contained a similar provision (see Article 8). It is, however, significant that Regulation 423 did not adopt the expansive definition of "*claim*" that is currently found in Regulation 267. Therefore, I find it difficult to accept Mr Fletcher's contention that the reason for the introduction of the expanded definition of "*claim*" in Regulation 961 was specifically linked to the derogation provision.

48. Second, Mr Fletcher's submission assumes that, while deciding to expand the scope of the definition of "*claim*" in Regulation 961/2010, those who drafted the Regulation did not foresee the impact that this would have on other provisions in the Regulation, most relevantly Article 29 (now Article 38). In my view, that is highly unlikely. If the intention was that the definition of "*claim*" should control the derogation provision alone, and not Article 29, one would have expected language to that effect or, at the very least, for the expanded definition of "*claim*" to appear as part of Article 17 and not alongside the general definitions in Article 1.

49. The second element of Article 38, that the claim must be "*in connection with any contract or transaction*", is also satisfied in my judgment. The relevant "*transaction*"

is the arbitration award that MODSAF seeks to enforce. Mr Fletcher submitted that it was an "*extremely difficult use of language*" to describe the arbitration award as being a "*transaction*". Although I recognise some force in this contention, I reject it for two reasons. First, Regulation 267 defines the term "*transaction*" fairly broadly. In Article 1(d) it is defined with the introductory phrase "*any transaction of whatever form and whatever the applicable law…*". Second, in Article 1(c), the term "*claim*" is defined as "*any claim… under or in connection with a contract or transaction, and includes in particular… (v) a claim for the recognition or enforcement… of a judgment an arbitration award or an equivalent decision*". As Mr Smouha pointed out, this definition appears to presuppose that, for the purposes of Regulation 267, judgments, arbitration awards and equivalent decisions do fall within the expression "*contract or transaction*".

50. The third element of Article 38 requires that the performance of the relevant contract or transaction must have been "*affected, directly or indirectly, in whole or in part, by the measures imposed under this Regulation*". Notably, Article 38 contemplates that the performance of the transaction may be affected "*in whole or in part*" by the sanctions. Therefore, IMS may resist enforcement of the interest component of the 7071 Award alone if it can establish that that part of the Award was affected by the measures imposed by Regulation 267.

51. Further, Article 38(2) clarifies that the performance of a contract or transaction shall be regarded as having been affected by the measures imposed by the Regulation where "*the existence or content of the claim results directly or indirectly from those measures*". For the purposes of the interest during the sanctions period issue, the relevant "*claim*" is MODSAF's application to enforce the interest component of the 7071 Award in respect of the sanctions period. As Mr Fletcher rightly pointed out, since the Awards pre-dated the sanctions, it is difficult to see how the "*existence*" of the claim can be said to have resulted from the sanction. However, in response, Mr Smouha submitted that even though the existence of the claim may not have been based on the sanctions, its content (insofar as it concerns interest) did result from the sanctions. I agree. As noted previously, during the sanctions period IMS was precluded from making payments to MODSAF to discharge its liability under the Awards. Thus, insofar as MODSAF seeks interest from IMS in respect of the sanctions period, it is seeking to enforce a liability of IMS whose content (i.e. the quantum of interest) is conditioned by, and in that sense "*results directly or indirectly from*", the sanctions.

52. The fourth and fifth elements are relatively straightforward, and I will consider them together. The fourth element simply sets out the consequence of the other components of Article 38(1) being satisfied namely, that the claim "*shall not be satisfied*". The fifth element is not contentious either. It is common ground that during the relevant period MODSAF was listed as a designated entity in Annex IX of Regulation 267.

53. For those reasons, I am satisfied that the language of Article 38 supports IMS's contention that, insofar as the interest component of the 7071 Award concerns the period during which MODSAF was a sanctioned entity, the enforcement of the Award is precluded by Article 38.

54. In my view, that result is reinforced by the purpose of Article 38, which I will now consider.

55. Regulation 267 does not contain a recital that explains the object or purpose of Article 38. As Mr Smouha pointed out, therefore, for guidance regarding the reason for introducing Article 38 one needs to turn back to Regulation 1110/2008. Regulation 1110/2008 is an earlier version of Regulation 267 which introduced a 'no claims' clause corresponding to Article 38 into the Iranian sanctions regime for the first time. Recital (4) of Regulation 1110 sheds some light on the purpose of Article 38. It reads as follows:

"*Regulation (EC) No 423/2007 imposed certain restrictive measures against Iran, in line with Common Position 2007/140/CFSP. As a result, economic operators are exposed to the risk of claims and it is therefore necessary to protect such operators permanently against claims in connection with any contract or other transaction the performance of which was affected by reason of the measures imposed by that Regulation*."

56. In this context, my attention was also drawn to the decision in *Shanning* where the House of Lords interpreted a 'no claims' provision similar to Article 38 in the context of sanctions against Iraq. The relevant provision in *Shanning* was Article 2 of Council Regulation (EEC) No 3541/91 which provided as follows:

> "*1. It shall be prohibited to satisfy or to take any step to satisfy a claim made by: (a) a person or body in Iraq or acting through a person or body in Iraq… (e) any person or body making a claim arising from or in connection with the payment of a bond or financial guarantee or indemnity to one or more of the above-mentioned persons or bodies, under or in connection with a contract or transaction the performance of which was affected, directly or indirectly, wholly or in part, by the measures decided on pursuant to the United Nations Security Council Resolution 661 (1990) and related resolutions.*"

57. The question before the House of Lords in *Shanning* was whether the 'no claims' clause in the Iraqi sanctions regime continued to have effect even after the sanctions were lifted. Although that question that does currently arise in the present case, Lord Bingham's explanation of the intent and effect of Article 2 of Regulation 3541/91 is, in my view, equally relevant here. Lord Bingham said (at [18] and [19]) that:

> "*…The embargo on trade and financial dealings with Iraq was imposed in the immediate aftermath of the Iraqi invasion of Kuwait in the hope that it would coerce Iraq to withdraw its forces within its own borders. This embargo had the inevitable and intended effect of halting the performance of current contracts. This prevented non-Iraqi contractors and suppliers from fulfilling their contractual obligations and so put them in breach of contract, subject to any defence of frustration or force majeure which might (or might not) be available to them under any relevant law or in any relevant court… Resolution 687 plainly looked forward to the end of the embargo, but it also expressed a very clear intention that no claim should lie at the instance of any Iraqi entity in connection with any transaction*

> *where performance had been affected by the embargo. The Community travaux préparatoires and Regulation (EEC) No 3541/92 expressed the same clear intention. Were the ending of the embargo to be accompanied by removal of the prohibition on satisfaction of claims against non-Iraqi contractors and suppliers, it is obvious that those who had been involuntarily prevented from performing their contracts would or might become liable to their Iraqi opposite numbers, with the result that the ultimate losers as a result of Iraq's gross violation of international law would be the non-Iraqi contractors and suppliers and not the Iraqi entities (including the government) which the embargo was intended to injure.*
>
> *…Shanning had performed a very substantial part of its contract. It had almost earned its contractual reward. It was prevented by the embargo from completing the contract and earning its reward. But for the embargo it seems fair to assume that it would have done so. It may be regarded as an innocent victim of the international community's response to Iraqi lawlessness. It would be extraordinary if, even when the embargo is lifted and normal commercial relations are restored, it were to be exposed even to the risk of claims (and it is "the risk of claims" to which the fourth recital refers) by the Iraqi side.*"

58. Similarly, in the context of the sanctions imposed against Russia pursuant to Regulation No 833/2014, in *Rosneft v Concil & Others* (case T-715/14) the CJEU considered the purpose of Article 11, a provision materially identical to Article 38 of Regulation 267. At [206] of its judgment, the CJEU observed as follows:

> "*In so far as the applicants also challenge the proportionality of Article 11 of the contested regulation, as the Council contends, the provision precluding the satisfaction of claims laid down in that article is intended to prevent an entity targeted by the restrictive measures at issue from being able to procure performance of a prohibited transaction, contract or service or from obtaining a remedy under civil law for non-performance of such transactions, contracts or services. Such a provision thus ensures the effectiveness of the restrictive measures at issue, by reflecting in private law the effects of measures that have been properly adopted by the European Union, for so long as those measures are applicable. In that sense, Article 11 of the contested regulation must be considered a proportionate means of achieving the objective of the contested acts.*"

59. Based on these authorities, I consider that the purpose of Article 38 is to prevent civil claims being brought against a party as a result of the fact that their performance of a contract or transaction was impeded by the operation of the sanctions. I am satisfied that the application of Article 38 to prevent MODSAF from enforcing the interest

component of the 7071 Award in respect of the sanctions period falls well within that purpose. As noted previously, the relevant transaction for these purposes is the 7071 Award. During the sanctions period, the existence of the sanctions prevented IMS from discharging its liability to pay the sums due under the Award. That is the reason why, during the sanctions period, IMS came under a liability to pay interest on the principal sum due under the Award. By seeking leave to enforce the interest component of the 7071 Award in respect of the sanctions period, MODSAF is now bringing a claim to hold IMS liable as a result of the fact that IMS's performance of the relevant transaction, i.e. discharge of the debt due under the Award, was affected by the existence of the sanctions. In my view, that runs counter to the object of Article 38.

60. In the context of the debate about the object and purpose of Article 38, Mr Fletcher drew my attention to the English translation of a French article by Bastid-Burdeau published in (2003) 3 *Comité Français de l'Arbitrage* at page 752. The title of the article translates as "*Multilateral and unilateral embargoes and their impact on international commercial arbitration – States in international economic litigation*". In this article, the author traces the history of the 'no claims' provisions to the Gulf crisis in the 1990s and the fact that Iraqi domestic law did not permit non-Iraqi parties to invoke the defence of force majeure on the basis of the embargo against Iraq (see pages 766-767). That apart, I was unable to find anything in this article that sheds light on the purpose of Article 38 as derived from the authorities cited above.

61. Mr Fletcher also argued that interpreting Article 38 so as to deprive MODSAF of the opportunity to enforce the interest component of the 7071 Award in respect of the sanctions period would amount to giving it confiscatory effect. He placed particular emphasis on Recital 26 of Regulation 267 which provides that:

> "*This Regulation respects the fundamental rights and observes the principles recognised in particular by the Charter of Fundamental Rights of the European Union and in particular the right to an effective remedy and to a fair trial, the right to property and the right to protection of personal data. This Regulation should be applied in accordance with those rights and principles.*" (emphasis added)

62. Mr Fletcher submitted that MODSAF's right under the Award to receive post-award interest is akin to a property right. Article 38 should not be interpreted so as to deprive MODSAF of that right.

63. Developing this point further, Mr Fletcher relied on Recital (1) of Regulation (EC) No 423/2007 (an earlier version of Regulation 267) to submit that the purpose of the sanctions regime is to "*persuade*" Iran to comply with UN Security Council Resolution 1737 (2006). The sanctions are meant to be rehabilitative rather than punitive. As he put it, they use a 'carrot and stick' approach to have persuasive effect. Mr Fletcher submitted that confiscation, being permanent, is 'stick' alone. It is, therefore, inconsistent with the purpose of Regulation 267.

64. I am unable to accept those submissions for two reasons. First, regardless of the objective that Regulation 267 as a whole seeks to achieve, I consider that Article 38 serves a specific purpose. As explained above, that is to protect parties against claims

being brought against them by virtue of their non-performance of a contract or transaction that was caused by the sanctions. Put differently, the objective of Article 38 is to ameliorate the impact of the sanctions regime on private relationships. As the Bastid-Burdeau article clarifies, provisions like Article 38 are "*unusual*" in that they concern private relationships although the Regulation as a whole primarily concerns "*essentially interstate issues*" (see page 767). For the same reason, the purpose of Article 38 may be said to be ancillary to the objective of the Regulation as a whole. In my view, therefore, a purposive interpretation of Article 38 must pay attention not just to the objective of the Regulation as a whole but also to the specific legislative aim that underlies Article 38.

65. Second and in any case, I am not persuaded that depriving MODSAF of its right to claim interest during the sanctions period is inconsistent with the objective of the Regulation as a whole i.e., to persuade Iran to comply with UN Security Council Resolution 1737 (2006). On the construction of Article 38 that I regard as being correct, the longer Iran continues to remain non-compliant with Resolution 1737, the longer Regulation 267 remains in place, and the longer is the period for which MODSAF is deprived of post-award interest under the 7071 Award. It is difficult to see why this is inconsistent with what Mr Fletcher described as the 'carrot and stick' approach of the sanctions regime.

66. In support of MODSAF's preferred construction of Article 38, Mr Fletcher also prayed in aid Article 29 of Regulation 267. As noted earlier, Article 29 provides that:

> "*1. Article 23(3) shall not prevent financial or credit institutions from crediting frozen accounts where they receive funds transferred onto the account of a listed natural or legal person, entity or body, provided that any additions to such accounts shall also be frozen…"*
>
> *2. Article 23(3) shall not apply to the addition to frozen accounts of:*
>
> *(a) interest or other earnings on those accounts; or*
>
> *(b) payments due under contracts, agreements or obligations that were concluded or arose before the date on which the person, entity or body referred to in Article 23 has been designated by the Sanctions Committee, the Security Council or by the Council;*
>
> *provided that any such interest or other earnings and payments are frozen in accordance with Article 23(1) or (2).*"

67. Plainly, Article 29(1) is inapplicable to IMS; it is restricted to the crediting of frozen accounts by "*financial or credit institutions*". IMS is not a "*financial institution*" or a "*credit institution*" according to the definition of those terms in Articles 1(i) and 1(f) of Regulation 267. Understandably, therefore, Mr Fletcher relied more heavily on Article 29(2). However, I am not persuaded that Article 29(2) takes matters much further either.

68. Mr Fletcher relied on Article 29(2)(a) as evidence of the fact that the Regulation does not prevent interest from accruing even during the period when the sanctions remain in force. He submitted that, in view of what Article 29 provides, it would be odd if Article 38 had the effect of preventing the accrual of interest during the sanctions period. The difficulty with this argument is that it can be turned on its head. If, as Mr Fletcher contends, Article 38 does not prevent interest from accruing during the sanctions period, then what purpose does Article 29(2) serve?

69. As Mr Smouha pointed out, therefore, the better view is that Article 29 and Article 38 are intended to cater to two different scenarios. Article 29(2)(a) is a statement of the general rule that Article 23(3) does not prevent the addition of interest or other earnings into a frozen account. This general rule is not concerned with the nature of a party's entitlement to interest. The application of Article 38, in contrast, is contingent on the reason why the claim for interest arises. It bites only if the claim for interest is a claim "*in connection with any contract or transaction the performance of which was affected*" by the sanctions. Therefore, I do not consider that Article 29 provides any support for Mr Fletcher's interpretation of Article 38.

70. For all those reasons, I am satisfied that Article 38 precludes MODSAF from enforcing the interest component of the 7071 Award in respect of the sanctions period.

Article 42

71. In the light of the conclusion that I have reached in relation to Article 38, the interpretation of Article 42 does not strictly arise for determination. Nevertheless, having heard submissions on this topic, I will express my conclusions briefly.

72. The material part of Article 42 reads as follows:

> "*1. The freezing of funds and economic resources or the refusal to make funds or economic resources available, carried out in good faith on the basis that such action is in accordance with this Regulation, shall not give rise to liability of any kind on the part of the natural or legal person, entity or body implementing it, or its directors or employees, unless it is proved that the funds and economic resources were frozen or withheld as a result of negligence*."

73. Article 42(1) is an expansively drafted provision. If it were to be construed in a purely literal fashion, it seesm to me that Article 42(1) would have the effect of precluding MODSAF from enforcing the interest component of the 7071 Award in relation to the sanctions period. During the sanctions period, IMS failed to make payments that were due to MODSAF under the Awards. This constitutes a "*refusal to make funds or economic resources available*". Further, IMS's actions were taken in good faith, non-negligently and on the basis that they were in accordance with Regulation 267. Solely by reference to the text of Article 42(1), therefore, the consequence that IMS's actions "*shall not give rise to liability of any kind*" must follow. In broad terms, this was the thrust of Mr Smouha's submissions on this issue.

74. Mr Fletcher sought to resist this conclusion as a matter of the language of Article 42(1). He submitted that, in order to attract the application of Article 42(1), it must be IMS's

refusal to make funds or economic resources available that 'gave rise to' its liability for interest. He argued that IMS's liability for interest arose from the 7071 Award, not its non-payment to MODSAF. As evidence of this, he pointed to the fact that IMS's liability for interest existed even before the sanctions regime came into force.

75. The difficulty with this argument is that it assumes that the 7071 Award and IMS's non-payment during the sanctions period are mutually exclusive reasons for IMS's liability to pay interest. I am not persuaded that this is the case. The better view is that the 7071 Award and IMS's non-payment are both necessary (but not independently sufficient) reasons for IMS's liability to pay interest in respect of the sanctions period. In that sense, they could both be said to have 'given rise to' IMS's liability for interest.

76. Nevertheless, I consider that the proper scope of Article 42(1) is narrower than a plain reading of its language suggests. As Mr Fletcher argued in his written submissions, the purpose of Article 42(1) is to provide protection for those who have mistakenly (but non-negligently) frozen funds or economic resources, or refused to make them available, by reference to the sanctions regime. The scope of its operation must accordingly be restricted. That is to say, the scope of Article 42(1) must be confined to cases of incorrect but non-negligent actions taken in good faith by reference to the sanctions regime. It follows that it has no application in cases where the relevant liability arises from a proper application of Regulation 267.

77. There are a number of indications in Regulation 267 that the scope of Article 42(1) was intended to be restricted in this way.

78. First, if Article 42(1) was intended to protect parties whose liability resulted from a proper (i.e. non-mistaken) application of Regulation 267, the requirement that their actions must have been "*carried out in good faith*" would be an odd stipulation. This would mean that, in order to be protected from liability by Article 42(1), not only must a party apply Regulation 267 correctly it must also do so in good faith. Moreover, the protection offered by Article 42(1) is not available if the funds or economic resources were frozen or withheld as a result of negligence. It is difficult to see how the negligence exception can have any useful role to play in cases where the Regulation was correctly applied.

79. Second, the inference that Article 42(1) is intended to protect parties against liability arising from mistaken applications of the sanctions regime is reinforced by the context in which Article 42(1) appears. Thus, Article 42(2) protects parties from liability for violating the prohibitions contained in Regulation 267 if "*they did not know, and had no reasonable cause to suspect*" that their actions would have that effect. Similarly, Article 42(3) protects parties from liability arising from good faith disclosures made pursuant to Articles 30, 31 and 32.

80. Third, as set out above, what is now Article 38 was first introduced as Article 12a of Regulation 1110/2008. Alongside Article 12a, Regulation 1110 also introduced Recital (4) that sought to explain its purpose by reference to the need to "*protect economic operators against claims in connection with any contract or other transaction the performance of which was affected by reason of the measures imposed by that Regulation*". Notably, a provision corresponding to Article 42 was already part of the sanctions regime even before the introduction of Article 12a by Regulation 1110 (see

Article 12 of Regulation 423/2007). If Article 42 and its predecessor provisions were intended to have the broad scope that Mr Smouha wishes to ascribe to them, one would have expected a recital corresponding to Recital (4) to have been part of the scheme of the Regulations even before the introduction of Article 12a by Regulation 1110/2008.

81. In response to these points, Mr Smouha did not seek to argue that Article 42(1) was inapplicable to mistaken, non-negligent and good faith applications of Regulation 267. His contention was that Article 42(1) was not confined to such cases. He submitted that it would be "*bizarre*" for the Regulation to protect parties from liability arising from a mistaken application of the Regulation but to offer no protection where liability arises from actions taken properly in accordance with it. While I accept that this would be a bizzare consequence, I am not persuaded that the narrow construction of Article 42(1) leads to that result. This is because, independently of Article 42(1), insofar as liability is incurred as a result of actions taken in accordance with the Regulation, parties are likely to be protected by Article 38(1). Indeed, one of the consequences of Mr Smouha's expansive construction of Article 42(1) is that it leaves very little scope for the operation of Article 38. In my view, this is yet another reason that reinforces the narrow interpretation of Article 42(1).

82. For those reasons, I am satisfied that the expansive language of Article 42 must be construed narrowly such that its scope is restricted to cases where liability arises from mistaken, but non-negligent, actions taken by reference to Regulation 267. It follows that Article 42 has no application in the present case.

Conclusion

83. For the above reasons, I conclude that Article 38 of Regulation 267 precludes MODSAF from enforcing the interest component of the 7071 Award in respect of the sanctions period. Although Article 42 is expansively worded, when properly construed, I do not consider that it is applicable in the present case.

84. In passing, I note that the above conclusion is consistent with the position stated in the OFSI's 'Financial Sanctions Guidance'. Although the guidance clarifies that "*OFSI cannot issue definitive guidance on how an EU or UK court might interpret these laws*", in reponse to question 3.4.10 of the 'Frequently Asked Questions' (page 31), the Guidance states as follows:

> "*If a court has ordered a judgment in favour of a person subject to an asset freeze, under EU regulations, and there are no licensing grounds to allow the payment to be made, the third party cannot be made subject to any further liability (such as accruing interest) for their non-payment while the sanctions continue to apply"*.

85. It follows that the total quantum due in respect of the Awards should be recalculated on the above basis, following which the amount of security which may now be returned to IMS may readily be ascertained. I invite the parties to agree those figures.