



Summary

- Policy objective: to deter commercial deals with targeted regimes that are beyond the scope of current EU/UN sanctions regimes, thereby increasing the scope and efficacy of sanctions' tools at our disposal and further reducing the ability of targeted regimes to sustain themselves.
- Mechanism: declaring that from a given date any new contracts entered into with a targeted regime (possibly in specified sectors, or with exceptions) will be unenforceable in the jurisdictions of participating states ("contract sanctions")
- Implementation: via the UN or EU as a restrictive measure; or through domestic primary legislation, preferably in conjunction with additional states in major centres of contract law.
- Consultation: benefits / risks of contract sanctions and means of implementation

Introduction

Sanctions are a key foreign policy tool designed to:-

- coerce a change in behaviour of a targeted regime,
- constrain a targeted regime's ability to act in a particular way, or
- signal the international community's disapproval of the regime's behaviour.

They are imposed in response to a variety of activity e.g. terrorism, nuclear proliferation, violation of international law, human rights violations.

Sanctions typically include an arms embargo, financial sanctions and a travel ban on targeted individuals or entities. They can also include other trade restrictions. Sanctions that are imposed by the EU prohibit business with listed countries by EU nationals or companies, or where the goods or services pass through the EU's territory.

The Government is constantly looking for new and innovative ways to maintain and/or expand its sanctions toolkit, so that sanctions apply as much pressure as possible when imposed. Implemented in this way the sanctions have the best chance of achieving their aims. The FCO is considering the application of **contract sanctions** as a new type of sanction in the context of the FCO's Smarter Sanctions objectives: measures that are **lawful, implementable and targeted**; which maximise a well-defined and realistic intended **impact**, but minimise legal, reputational or economic **risk** to the UK. We are now consulting interested parties on the feasibility of developing a system of **contract sanctions** with a view to identifying the potential benefits and risks in addition to options for implementation

Contract Sanctions

The Government is seeking views on contract sanctions as a measure, unilateral or multilateral, which would increase the pressure on repressive regimes or countries engaged in proliferation of nuclear technology and extend the scope of traditional sanctions, to provide disincentives to the private sector outside the EU from doing business with targeted regimes.

We would particularly welcome views on the likely impact of implementing this new type of sanction and identification of any possible risks.

How would contract sanctions work?

Contract sanctions would restrict the courts of participating states from enforcing contracts prospectively entered into with a targeted regime.

For example, the government of country X wishes to import goods which would, for example, sustain its ability to repress the civilian population. It cannot source these from the EU due to the sanctions regime in place. But it is free to do so from countries that have not. The aim of contract sanctions would be to dissuade others outside the EU from entering into a contract to supply that country by making such a contract unenforceable in the courts of participating countries.

If countries with other major legal jurisdictions imposed similar measures, this could provide a disincentive for those still prepared to supply goods to sanctioned regimes by casting doubt on the ability to enforce the contract in those jurisdictions with the regime or its successors.

Implementation

We have identified three options by which **contract sanctions** could be implemented in the UK:

- **UK** primary legislation, subject to compatibility with applicable EU law, setting out clearly defined criteria under which a target regime may be considered eligible for contract sanctions and enabling the Secretary of State to impose contract sanctions on a regime when those criteria are fulfilled. The effect of this would be to prohibit domestic courts and tribunals from enforcing contracts entered into with the targeted regime post a declaration being made. To be most effective contract sanctions would benefit from being imposed by a sufficiently broad group of countries including the world's key financial and legal centres.
- Imposition of contract sanctions by the **EU** as a restrictive measure - either as part of a package of sanctions measures or as stand-alone measure which can be implemented without the need for agreeing full sanctions. The effect would be to prevent any courts or tribunals within the EU from enforcing contracts prospectively entered into with the targeted regime.
- Imposition of contract sanctions by the **UN** as a restrictive measure and then implementation by the EU.

Potential Benefits

As part of a package of wider sanctions, **contract sanctions** could discourage new contracts with, or loans to, a targeted regime because the contracts would be at risk of becoming unenforceable in the world's main jurisdictions for contractual disputes. Implemented multilaterally via the EU or UN, in conjunction with the US, they could be even more effective.

Discouraging such contracts or loans could make it more difficult and more expensive for a targeted regime to sustain itself and potentially increase the impact of sanctions.

They could also encourage senior officials or military officers to abandon the regime and/or cause outsiders considering doing business with the regime to drive a harder bargain in order to compensate for the high level of risk associated with any such business. It could also make it difficult to enforce contracts with successor Governments in the major international legal/financial centres.

Traditional sanctions prohibit the movement of certain goods, funds or persons. They only bind the countries that have signed up to them, and rely on those countries enforcing these prohibitions effectively. **Contract sanctions** have a potentially wider sphere of influence in that they act as a disincentive to anyone signing a contract with a target regime regardless of where the individual/entity is based. In this way they have greater potential to influence the behaviour of a wide range of international actors who may not be subject to e.g. EU law. This might be particularly useful when there is a lack of consensus over whether to adopt "traditional" sanctions in response to a crisis.

Potential Risks

While **contract sanctions** are intended to discourage business being done with a targeted regime by increasing the risk attached to contracting with that regime, is there a risk that the kind of companies that supply repressive regime would not be deterred?

Might the higher cost of borrowing that the target regime would experience under contract sanctions prove attractive to certain traders as a high risk/high reward investment?

If investors and lenders continued to sign contracts with the target regime after the declaration of contract sanctions might they be incentivised to protect their investment by increasing the scale of such lending and therefore further bolstering the regime?

Is there also a risk of negative impact on the UK legal services sector by undermining the perception of the UK as an attractive jurisdiction in which to settle contractual disputes owing both to the reliability of the UK legal system and the concentration of legal expertise that has grown up in London to cater for international clientele?

Should the UK become a less attractive place to settle contractual disputes is there a long term risk that some international businesses might move away from London towards emerging financial centres in jurisdictions where contract sanctions have not yet and might never be declared?

Consultation

We would welcome views on the idea of introducing this type of sanction. We would also welcome views on the following questions:

- Would contract sanctions deter the private sector from doing business with targeted regimes? Or would it be relatively simple for those who do business with such regimes to find ways around contract sanctions?
- Do you share the assessment of the potential merits of contracts sanctions set out in this paper?
- Are there additional benefits or strengths that we have not identified? If so what are they?
- Have we identified the key risks around this policy development? Are there others? What measures might mitigate the risks identified?
- Do you agree with the identified means of implementing contract sanctions in the UK? If not, why not?
- Are there alternative means by which such a policy might be implemented?
- Who else should we be consulting within the UK?

How to respond and by when

Please send your responses to this consultation by email to the following address:

PCS.Consultation@fco.gov.uk . Any questions you have about this consultation may also be addressed to this mailbox which will be monitored on a daily basis. Your comments should be made by no later than noon on **Friday 14 March**.