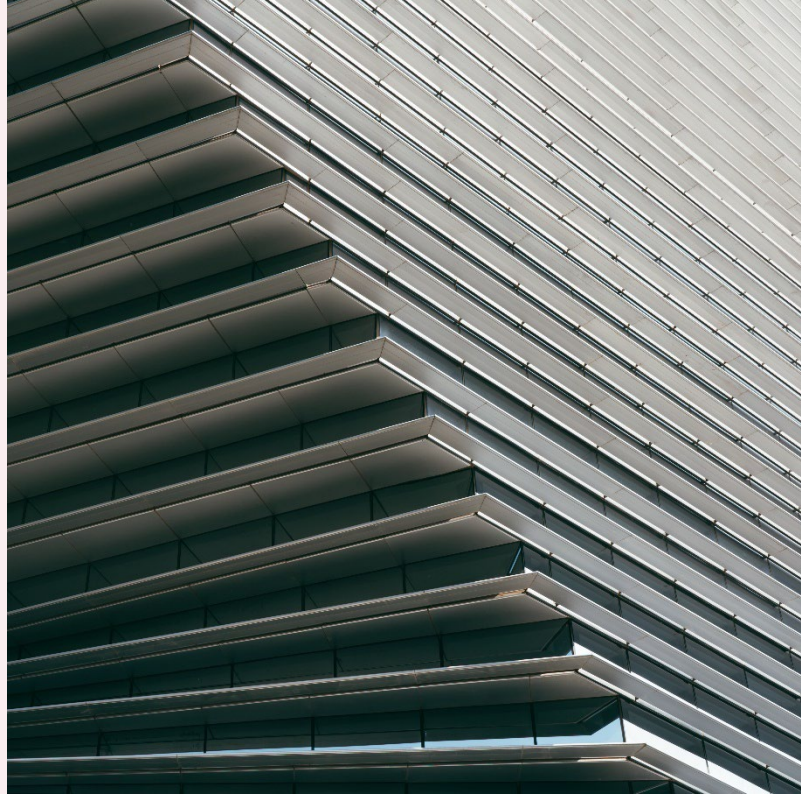


Sanctions Clauses: Lessons from the Court of Appeal

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The Court of Appeal has considered the effect of a sanctions clause that excused a party from performance where, in that party's reasonable judgment, it would otherwise be at risk of sanctions liability. The unanimous judgment is commercial and pragmatic: it supports the use of desktop searches to identify potential risks; "*common sense*" when assessing those risks; and healthy scepticism of attempts to explain the risks away.

Key points

- 1 Sanctions clauses can be very valuable, but the precise wording of the clause is important. Does it excuse non-performance where there is merely a risk of sanctions or only where it is clear that sanctions would be contravened? Who decides whether there is such a risk, or does it have to be objectively determined? Which sanctions are covered?
- 2 Where the clause is appropriately drafted, the use of desktop searches from reputable sources is an appropriate way to assess risk. A counterparty's own contrary evidence need not be accepted at face value.
- 3 It is important to document the decision-making process properly so that the reasonableness of the decision can be evidenced if contested by the counterparty or a regulator.
- 4 Deviation from gold-standard wording creates risk: what is permissible under one contract may not be permissible under another. Without a sanctions clause, a party will need to rely on common law illegality to determine if there is a basis on which to refuse performance, and that may not be the desired answer, even where performance might cause a party to contravene a sanctions regime to which it is subject.

Background

The claimant in Tonzip Maritime Ltd v 2Rivers Pte Ltd was the Owner of an oil tanker. The defendant had chartered the tanker for a specific voyage under a standard form (ExxonMobil VOY2005) charterparty signed in November 2021. Certain clauses had been amended and added to the standard form, including an additional clause relating to sanctions compliance.

The relevant part of the sanctions clause read as follows:

"THE OWNERS SHALL NOT BE OBLIGED TO COMPLY WITH ANY ORDERS FOR THE EMPLOYMENT OF THE VESSEL IN ANY CARRIAGE, TRADE, VOYAGE, SHIP-TO-SHIP TRANSFER OPERATION OR OTHER SERVICE WHICH IN THE REASONABLE JUDGEMENT OF THE OWNERS, IS PROHIBITED BY SANCTIONS OR WILL EXPOSE THE OWNERS, THE VESSEL OR ITS MANAGERS, CREW, THE VESSEL'S INSURERS OR REINSURERS TO SANCTIONS. IN THE EVENT THAT SUCH RISK ARISES IN RELATION TO A VOYAGE THE VESSEL IS PERFORMING, THE OWNERS SHALL BE ENTITLED TO REFUSE FURTHER PERFORMANCE AND THE CHARTERERS SHALL BE OBLIGED TO PROVIDE ALTERNATIVE VOYAGE ORDERS."

The Charterer ordered the Owner to load a certain cargo. The shipper of the cargo was identified as Neftisa, a Russian oil company reported to be closely associated with a sanctioned individual. The Owner refused to load the cargo, relying on the above sanctions clause. The resulting dispute was heard in the English High Court and the Owner appealed.

Issue 1: Contractual Interpretation

The Court of Appeal upheld the High Court's finding that the clause permitted the Owner to refuse performance if, in its reasonable judgment, there was a real risk that performance would contravene sanctions. The Owner did not have to determine that performance would in fact contravene sanctions.

Lord Justice Foxton's discussion of this issue re-emphasises that while English law focuses first on the precise words used by the parties in their contract, it does not do so slavishly or blindly. Most notably:

- Since the charterparty was an amalgam of clauses from different sources (a standard form, negotiated amendments and bolt-on clauses taken from other standard industry terms), it was not appropriate to assume that the word "expose" had the same meaning in every clause in which it appeared. (By contrast, where a contract has a single draftsman, there may be a presumption that the drafter "aims at uniformity in the structure of his [sic] draft".)
- The commercial context was important. The Owner was likely to have much less information than the Charterer regarding the facts necessary to determine whether a particular voyage might be prohibited by sanctions. Sanctions are often complex and the Owner would be required to make a speedy decision as to whether or not to accept the Charterer's instruction to load a cargo. In that context, it was more likely that the Owner was required only to make a judgment

as to the existence of a risk, rather than to form a view on a complicated legal issue. (Foxton LJ distinguished this from insurance contracts: "*The decision whether or not an insurance claim should be paid does not involve a decision "in the heat of the moment" in the manner of a decision to follow or continuing to follow a voyage order.*")

Issue 2: "Reasonable Judgment"

The second issue on appeal was whether the Owner had formed a reasonable judgment that there was a risk of a sanctions breach. The Court of Appeal found that it had and so allowed the appeal on this ground.

The sanctions risk in this case arose because of Neftisa's association with Mr Gutseriev, a Russian businessman who was designated for the purpose of EU and UK sanctions in June and August 2021. Before his designation, Mr Gutseriev was indirectly the 100% owner of Neftisa. After the designation, he transferred his ownership interest to his brother. He also ceded his position as Head of the Board of Directors of Neftisa to his brother.

These transfers were flagged in the information available to the Owner – including Refinitiv World-Check reports and an Infospectrum report – when the Owner made its decision to refuse the Charterer's request. The conclusion that Mr Gutseriev might still exercise *de facto* control over Neftisa even after the paper transfers to his brother was held to be reasonable: Foxton LJ went so far as to say that "*the point ... that the purported transfer of an interest to a family member in such circumstances is potentially a red flag of a cosmetic transfer is a matter of common sense.*"

In an effort to convince the Owner that there was no sanctions risk, the Charterer provided three documents which it said supported that conclusion. But the Court of Appeal held that those documents had the opposite effect:

- A letter on Neftisa letterhead "*only addressed the position under Russian law, and was very brief. The only source of information given was a corporate shareholder and the letter was devoid of detail. It is exactly the sort of letter which would have been sent had there been a cosmetic transfer of Mr Gutseriev's interest for the purpose of seeking to avoid sanctions.*"
- A legal opinion from an international law firm was "*premised on factual assumptions, whereas any risk of sanctions depended on whether or not those factual assumptions were correct.*" The same issue applied to another legal opinion from a second international law firm; but that opinion additionally made it clear that a sanctions risk could arise.

The nature of the documents provided by the Charterer was therefore further evidence that the proposed voyage might give rise to a sanctions risk. As Foxton LJ put it:

"The package of information provided by Neftisa through the Charterers would ordinarily have been expected to advance the position that there was no sanctions risk in the transaction to its strongest effect. However, the material provided essentially rests on assumptions originating from

a source which could not have offered an independent perspective on the reality of any transfer of control. The BM memorandum would, if anything, have led a reasonable owner to be even more confident that following the Charterers' orders involved a real risk of sanctions liability."

Against that backdrop, it did not matter that another source of information offered "a potentially more positive spin". The overwhelming impression was that there was a real risk of sanctions liability.

Conclusion

This decision should be reassuring to those dealing with the day-to-day complexities of sanctions. It recognises the speed at which decisions must be taken in some contexts; and supports the use of diligence processes which will be familiar to those involved in global compliance functions.

However, it is reassuring only if you have a clause that entitles you to delay or refuse performance with the same level of autonomy as that afforded by the sanctions clause in *Tonzip's* charterparty. Phrases like "*in the reasonable judgment of the Owners*" are often heavily negotiated. Where no such clause exists (as in the recent case of *Eurochem North-West-2 and another v Société Générale S.A. and others*), the party seeking to rely on sanctions to excuse performance will need to satisfy itself (and, if necessary, prove at trial) not only that there is a real risk of sanctions liability, but that contractual performance would in fact contravene sanctions.

Tonzip therefore reinforces the following messages:

- A sanctions exclusion clause can be a very valuable tool. Without a sanctions clause, a party will need to rely on common law illegality to determine if there is a basis on which to refuse performance, and that may not be the desired answer, even where performance might cause a party to contravene a sanctions regime to which it is subject.
- The precise wording of the clause is important. Does it excuse non-performance where there is merely a risk of sanctions or only where it is clear that sanctions would be contravened? Who decides whether there is such a risk, or does it have to be objectively determined? Which sanctions are covered?
- Deviation from gold-standard wording creates risk, particularly in high-volume transaction environments where there are many different contracts with many different counterparties. What is permissible under one contract may not be permissible under another.
- Where a party has the benefit of a clause like the one in Tonzip, the use of desktop searches from reputable sources is an appropriate way to assess risk and a counterparty's own contrary evidence need not be accepted at face value. It is nevertheless important to document the decision-making process properly so that the reasonableness of the decision can be evidenced if contested by the counterparty or a regulator.



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