Modification or termination of contracts due to international economic sanctions from the standpoint of Russian legislation and court practice

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For citation: Goriacheva, Anastasia I. 2022. "Modification or termination of contracts due to international economic sanctions from the standpoint of Russian legislation and court practice". *Vestnik of Saint Petersburg University. Law* 4: 877–895. https://doi.org/10.21638/spbu14.2022.403

In this article the author covers the problem of possible modification or termination of contracts due to international economic sanctions, in particular the US and EU sanctions against Russia. The author analyses relevant legislative acts, approaches of governmental authorities and court practice on this matter. This extensive analysis includes overview of development of main legal doctrines and institutions, related to the subject matter of this article. Moreover, it covers definitions of the relevant terms. This article is mainly aimed at defining a list of criteria to rely on when determining the possibility to modify or terminate a contract due to international economic sanctions in each particular case. The author raises the hypothesis that possibility to modify or terminate a contract due to international economic sanctions is subject to a closed list of criteria. The subject matter of this article is important since sanctions are now one of the main instruments of political influence in interstate relations and have a significant impact on all types of contractual relationships. Today, a major and common challenge faced by market participants is the inability to enforce contracts the way they were originally entered into. Due to the fact that in Russia it is rare for contracts to be amended or terminated due to newly imposed sanctions, parties do not always find themselves in a position to enforce a contract in a timely manner or to perform at all. As a result, the stability of the business environment is disrupted and the level of trust is reduced. Thus, it is highly important to perform a thorough analysis of this matter and provide possible solutions for market participants.

Keywords: international economic sanctions, sanctions, clausula rebus sic stantibus, substantial change of circumstances, contracts, hardship.

1. Introduction

The term "sanction" has multiple meanings and origins from the Latin "sanctio", which meant an inviolable law or a strictest decree. In legal literature and everyday life this term is most frequently used in the sense of means of enforcement in response to violation of legal norms (Evgen'eva 1999, 27). In international law, however, the term takes on a specific meaning. Namely, nowadays, it refers to means of enforcement in respect of foreign governments and persons, which have violated their obligations or international legal norms. This meaning has not always been the same.

In 20th century the meaning of term "sanctions" was limited solely to coercive measures taken by a decision of the UN Security Council[1]. As for one-sided extraterritorial coercive measures applied by states in the absence of a decision by the UN Security Council, such measures were declared illegitimate, inconsistent with international law and the UN Charter (Hofer 2017; Schmidt 2022)[2], and, therefore, did not fall under the concept of "sanctions". Specifically, in legal literature as of 1950–1990 unilateral economic measures were referred to as "economic coercion" (McDougal, Feliciano 1958; Bowett 1972; Parry 1977; Brosche 1974; Lillich 1976; Elagab 1988). Over a long period of time, the term "sanctions" referred merely to collective response by states to a violation of international law. Moreover, in preparing the Draft articles on State Responsibility, the UN International Law Commission avoided using the term "sanctions" in the text of the Draft Articles on State Responsibility, reserving it for measures adopted by decision of international organizations[3].

However, in circa 1980th a terminological switch occurred. For example, in 1985, the first edition of "Economic Sanctions Reconsidered" was published, in which the term "sanctions" included unilateral coercive economic measures (Hufbauer, Schott 1985; see also: Lenway 1988; Malloy 1990; Marossi, Bassett 2015; Neuwirth, Svetlicinii 2015).

At the moment, the definition of this term is unambiguous. This is also confirmed by the report of the Human Rights Council Advisory Committee, which noted that, despite the vigorous debate that this term has generated among scholars as well as among various UN bodies in recent decades, the definition of the term remains vague[4].

Today, most often economic sanctions are considered to encompass "any action taken by a nation or international body which is intended to prevent, regulate or otherwise hinder economic activity with another nation for the purpose of condemning or influencing the latter's actions or policies" (Moyer, Mabry 1988, 2; see also: Carter 1988, 4).

For research purposes the author examines specifically international economic sanctions (a. k. a. "sanctions") and defines them as follows:

> Any regulations or restrictive measures related to economic, financial or trade relations imposed by governmental bodies, which include the UN Security Council, the US Government, the US President, the Office of Foreign Assets Control ("OFAC"), the US State Department, the US Department of Commerce, the Council of the European Union, as well as Russian competent authorities[5].

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[1] *UN Charter. 1945. Ch. VII.* Accessed July 25, 2022. https://treaties.un.org/doc/publication/ctc/uncharter.pdf. — See also, e. g.: *Subsidiary Organs of the United Nations Security Council: Fact Sheets 2022.* Accessed July 25, 2022. https://www.un.org/securitycouncil/sites/www.un.org.securitycouncil/files/subsidiary_organs_factsheets.pdf.

[2] See, e. g.: *General Assembly Adopts Resolution Calling on States Not to Recognize Unilateral Coercive Economic Measures (October 16, 2002).* Accessed July 25, 2022. https://press.un.org/en/2002/ga10083.doc.htm.

[3] *Yearbook of the International Law Commission*. 1979. Vol. 1: 54–62. (In Russian)

[4] "Research-based progress report of the Human Rights Council Advisory Committee containing recommendations on mechanisms to assess the negative impact of unilateral coercive measures on the enjoyment of human rights and to promote accountability, A/HRC/28/74 (February 10, 2015), para. 7". *United Nations, General Assembly, Human Rights Council.* Accessed September 21, 2021. http://www.ohchr.org/Documents/HRBodies/HRCouncil/AdvisoryCom/CoerciveMeasures/A-HRC-28-74_en.doc.

[5] See, e. g.: "Sanctions: RIAC Handbook". *Russian International Affairs Council.* Accessed July 25, 2022. https://russiancouncil.ru/en/sanctions.

2. Basic research

2.1. Glimpse into international economic sanctions targeting Russia

2.1.1. Brief historical background

Since the author finds that the history of this legal instrument may be of interest in light of this research, below is provided the brief historical overview.

The history of sanctions can be traced back to Ancient Greece. According to ancient literary sources, in circa 432 B.C. the Athenian Maritime Union imposed restrictions similar to modern international economic sanctions on the city of Megara as part of the Peloponnesian War. Restrictions were imposed on the inhabitants of the city of Megara, whereby they were forbidden to be in the market, in the fields, on the land and at the sea (Aristophanes 1983, 34). Later, blockades became a particularly widespread method of political influence. International economic sanctions in the modern sense have been actively used since the First World War.

Sanctions against Russia featured on the agenda in 2014, when Crimea and the city of Sevastopol became part of Russia. Later, in respond to these sanctions Russia introduced the so-called counter-measures. The reasoning of the Russian counter-measures is based on numerous studies substantiating the illegality of the original foreign sanctions (Doraev 2016; Savel'ev 2015; Entin, Entina 2015). This reasoning is also partially based on acts of international organizations. For example, the inadmissibility of economic measures to exert influence on other states has been postulated in a number of UN documents as one of the core foundations of current international law. Coercive economic measures are considered to violate the entire system of basic principles of international law, especially the principle of non-intervention, as interpreted in the Declaration on Principles of International Law[6].

Specifically, unilateral economic measures were subject of special consideration within the framework of the General Agreement on Tariffs and Trade. In 1982 at the session of this organization a declaration was adopted, which stressed that the member states of the General Agreement on Tariffs and Trade ("GATT") "undertake individually and jointly to refrain from taking restrictive trade measures for reasons of non-economic nature inconsistent with the General Agreement"[7].

At the same time the GATT and General Agreement on Trade in Services of ("GATS") include provisions that *de facto* legalize unilateral economic measures. It concerns the right of WTO member-states to deviate from the requirements of GATT and GATS when there is a threat to their security.

As a result, sanctions are now one of the main instruments of political influence in interstate relations. Particularly, sanctions are often imposed to induce a foreign state to alter its domestic or foreign policy (Silveira 2014, 21).

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[6] "Declaration on Principles of International Law concerning Friendly Relations and Cooperation among States in accordance with the Charter of the United Nations, A/RES/2625(XXV) (October 1970, 24)". *United Nations, General Assembly.* Accessed September 21, 2021. https://www.refworld.org/docid/3dda1f104.html; *Proceedings of the United Nations Conference on Trade and Development (Geneva, 23 March — 16 June 1964)*. Vol. 1: *Final Act and Report*. 1964. New York, United Nations.

[7] *Ministerial Declaration No. L/5424 (adopted on November 29, 1982)*. Accessed September 21, 2021. https://www.wto.org/gatt_docs/English/SULPDF/91000208.pdf.

For the purposes of further analysis, it is necessary to look into the concept and types of sanctions, as well as the role they play in international private relations.

Many countries have developed their own independent sanctions regimes. Although, for the purposes of this article the author deems necessary to limit the scope of this research to the currently imposed US and EU sanctions.

2.1.2. General overview of US and EU economic sanctions

2.1.2.1. US economic sanctions

The United States tend to use economic coercion in respect of Russia in order to influence its political strategy. Robert Pape outlined tree main forms of economic coercion, namely economic sanctions, trade wars, and economic warfare (Pape 1997, 93–95). Out of all the forms of economic coercion the US policy toward Russia has focused on sanctions (Baldwin 1985; Hufbauer et al. 2009). As previously mentioned, in March 2014, the US introduced the first sanctions against Russia in connection with the situation in the Crimea and eastern Ukraine. First, sanctions touched upon solely specific people and companies. Therefore, these first sanctions were not very significant to the Russian economy. Though, already in July 2014, additional sectoral sanctions were imposed. These newly introduced sectoral sanctions addressed companies in three main sectors, namely financial, oil and gas, military. Since then, sanctions have become the US foreign policy instrument of choice in dealing with Russia (Ashford 2016)[8].

As of today, intense scientific discussions regarding the effectiveness of the sanctions imposed on Russia are still ongoing. Although the effect of these restrictive measures is often denied, it is necessary to mention a number of academic papers that analyze the impact of sanctions on the Russian economy. For example, E. Gurvich and I. Prilepskiy draw the following conclusion: "Aside from their direct effects, i. e., limited foreign borrowing opportunities for banks and companies in the fuel and energy and military-industrial sectors that are publicly held, the financial sanctions *have considerable indirect effects on the Russian economy in the form of decreasing foreign direct investment, fewer borrowing opportunities for companies and banks not directly targeted by the sanctions and lower capital inflow into the government debt market*. These indirect effects roughly triple the direct effects of the sanctions" (Gurvich, Prilepskiy 2015, 384).

Similarly, C. E. Ziegler wrote that "sanctions did impact the Russian economy, particularly during the economic downturn in 2014–2015, but by 2017 Russian energy, finance and defense sectors had returned to normal as the country utilized domestic resources and cultivated new foreign partners" (Ziegler 2020, 510).

Although the author finds these conclusions interesting, since the question of impact of the US sanctions is not the main subject of this article, the author decided not to enter into this discussion and focus on describing the sanctions regimes themselves.

Generally, the US sanctions can be divided into a number of sanctions regimes, such as:

— Ukraine-related sanctions under Executive Order 13660 "Blocking Property of Certain Persons Contributing to the Situation in Ukraine" dated March 6, 2014, Executive

[8] See also: "Treasury Designates Russian Oligarchs, Officials, and Entities in Response to Worldwide Malign Activity". *US Department of the Treasury.* 2018. Accessed September 21, 2021. https://home.treasury.gov/news/press-releases/sm0338.

Order 13661 "Blocking Property of Additional Persons Contributing to the Situation in Ukraine" dated March 16, 2014, Executive Order 13662 "Blocking Property of Additional Persons Contributing to the Situation in Ukraine" dated March 20, 2014, etc.;

— sanctions targeting significant malicious cyber-enabled activity under Executive Order 13694 "Blocking the Property of Certain Persons Engaging in Significant Malicious Cyber-Enabled Activities" dated April 1, 2015, Executive Order 13757 "Taking Additional Steps to Address the National Emergency with Respect to Significant Malicious Cyber-Enabled Activities" dated December 28, 2016, Executive Order 13848 "Imposing Certain Sanctions in the Event of Foreign Interference in a US Election" dated September 12, 2018;

— US nonproliferation sanctions under Russia-Related Directive dated August 26, 2019, Executive Order 13382 "Blocking Property of Weapons of Mass Destruction Proliferators and Their Supporters" dated June 28, 2005[9], etc.

There are two main groups of restrictions, namely blocking and sectoral sanctions. Below the author examines the both in more detail.

The list of individuals subject to the US blocking sanctions is called "Specially Designated Persons List" ("SDN List")[10]. The main feature of these sanctions is that they involve a complete blocking of funds of designated persons and a ban on entry into the US. In addition to the above, any dealings with designated persons or their subsidiaries are prohibited. In this context, subsidiaries shall be defined as those 50 % or more owned by designated persons, regardless of whether the subsidiary itself is listed. Moreover, if several shareholders are listed on the SDN List, their shares are summed up and the total percentage is calculated. Thus, if the company is owned, for example, by two designated persons, 25 % each, such a company will also be considered designated[11].

Unlike blocking sanctions, sectoral sanctions do not involve blocking of funds. There are specific restrictions set forth in the OFAC directives. As of today, four OFAC directives are in effect[12]. Each of these directives affects a different sector of the economy. For instance, the first directive targets the financial sector, the second and fourth directives target the energy sector, and the third directive targets the defense sector.

Notably, the US sanctions are only binding on "US persons", as in:

— companies incorporated under US law and their subsidiaries outside the US;

— individuals and companies in the US, even those temporarily located in the US;

— US citizens and residents, wherever they live or work;

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[9] All documents are available at GovInfo. Accessed July 25, 2022. https://www.govinfo.gov.

[10] *Specially Designated Nationals and Blocked Persons List (SDN) Human Readable Lists*. Accessed July 25, 2022. https://home.treasury.gov/policy-issues/financial-sanctions/specially-designated-nationals-and-blocked-persons-list-sdn-human-readable-lists.

[11] So-called "50 Percent Rule". See: "Revised Guidance on Entities Owned by Persons Whose Property and Interests in Property Are Blocked". *Department of the Treasury*. Accessed July 25, 2022. https://home.treasury.gov/system/files/126/licensing_guidance.pdf.

[12] *Directive 1 (as amended on September 29, 2017) under Executive Order 13662*. Accessed July 25, 2022. https://home.treasury.gov/system/files/126/eo13662_directive1_20170929.pdf; *Directive 2 (as amended on September 29, 2017) under Executive Order 13662*. Accessed July 25, 2022. https://home.treasury.gov/system/files/126/eo13662_directive2_20170929.pdf; *Directive 3 under Executive Order 13662*. Accessed July 25, 2022. https://home.treasury.gov/system/files/126/eo13662_directive3.pdf; *Directive 4 (as amended on October 31, 2017) under Executive Order 13662*. Accessed July 25, 2022. https://home.treasury.gov/system/files/126/eo13662_directive4_20171031.pdf.

— directors, employees, officers, agents located in the US regardless of nationality and citizenship[13].

In addition to the US sanctions outlined earlier, there are the so-called "secondary sanctions" related to involvement of individuals in certain activities (Meyer 2009). For example, such sanctions may be imposed on those operating in Crimea or investing in specific Russian oil extraction projects, etc.

2.1.2.2. EU economic sanctions

As for the EU sanctions, they were introduced almost simultaneously with the US sanctions. These restrictive measures, however, cover a smaller list of Russian persons and have a less significant impact on the Russian economy. The effectiveness of the EU sanctions is also often questioned: "Closer coordination between sanctions and other policy instruments could be beneficial, including closer synchronisation with mediation efforts, referrals to legal tribunals and more creative use of assistance to member states and sectors negatively affected by sanctions. A more strategic use of the threat of sanctions could also be useful" (Moret et al. 2016, 5).

There is an opinion that the EU sanctions would be more effective if they were combined with other policies and stronger international cooperation with third states or organizations (Hörbelt 2017).

Generally, the EU sanctions function in a similar way. In particular, the EU has also developed a list of designated persons who are subject to blocking sanctions, "Designated Persons List"[14]. The persons on this list are subject to similar restrictions, such as blocking of funds, a ban on entry into the EU, and a prohibition to directly or indirectly access any funds or economic assets. Importantly, the latter restriction applies not only to the designated persons *per se*, but also to companies that are 50 % or more owned or controlled by such persons[15].

In addition to the above, the EU also imposes sectoral sanctions and restrictions related to reunification of Crimea with Russia[16].

The EU sanctions can also be divided in several sanctions regimes as follows:

— Ukraine-related sanctions under Council Regulation (EU) No. 208/2014 dated March 5, 2014, Council Regulation (EU) No. 269/2014 dated March 17, 2014, Council Regulation (EU) No 833/2014 dated July 31, 2014, Council Decision No. 2014/512/CFSP dated July 31, 2014;

— Crimea-related sanctions under EU Council Regulation No. 692/2014 dated June 23, 2014, Council Decision No. 2014/386/CFSP dated June 23, 2014;

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[13] See, e. g.: "A Regulated World Sanctions". *Freshfields Bruckhaus Deringer.* 2017. Accessed July 25, 2022. https://www.freshfields.com/globalassets/our-thinking/campaigns/sanctions_guide.pdf.

[14] See: *Consolidated text of Council Regulation (EU) No. 269/2014 dated March 17, 2014 concerning restrictive measures in respect of actions undermining or threatening the territorial integrity, sovereignty and independence of Ukraine*. Accessed July 25, 2022. https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02014R0269-20220604.

[15] See, e. g.: "Sanctions". *Standard Club.* Accessed July 25, 2022. https://www.standard-club.com/knowledge-news/sanctions.

[16] See, e. g.: "EU restrictive measures against Russia over Ukraine (since 2014)". *Council of the European Union.* Accessed July 25, 2022. https://www.consilium.europa.eu/en/policies/sanctions/restrictive-measures-against-russia-over-ukraine.

— chemical weapons-related sanctions under Council Decision (CFSP) No. 2018/1544 dated October 15, 2018;

— cyber-related sanctions under Council Regulation (EU) No. 2019/796 dated May 17, 2019, Council Decision (CFSP) No. 2019/797 dated May 17, 2019, Decision (CFSP) No. 2020/1127 and Council Implementing Regulation (EU) No. 2020/1125 dated July 30, 2020[17], etc.

It is, however, important to stress that only EU-registered organisations, their branches, directors, employees and agents need to comply with all of the above restrictions.

It needs to be underlined here that due to the purpose of this study, the author found it unnecessary to describe all the US and EU sanctions regimes and focused solely on the most important ones.

2.2. Modification or termination of contracts due to international economic sanctions in Russia

2.2.1. Brief history of clausula rebus sic stantibus

A review of the *rebus sic stantibus* clause should begin with a brief history of its origin. According to Roman law, the debtor could not refuse to fulfill his obligations in the event of "substantial change of circumstances" (Thier 2011, 16). Lawyers relied on the principle "*pacta sunt servanda*" and assumed that the parties had to envisage all possible changes of circumstances when concluding a contract. This principle indicates that once a contract has been concluded by the parties, it must be performed. Should the parties fail to perform their obligations, they will become subject to enforcement. It was allowed to terminate a contract only as a result of complete *de facto* or *de jure* impossibility of performance.

The evolution of Roman law gave rise to the idea that performance of obligations under a contract, regardless of *de facto* circumstances, is not always correct and fair. For example, Marcus Tullius Cicero (De Officiis 3, 95) described the following situation: if the owner of a sword had deposited it and was later declared insane, it would be unreasonable to return the sword to him (Thier 2011, 16). As a ground for non-performance, Marcus Tullius Cicero designated exactly the circumstances that arose during the performance of the contract, in which the performance of obligations under the contract would be a direct threat both to the creditor and to third parties. The same example was later used by Aurelius Augustine (Psalmum V, 7 in fine)[18] to illustrate situations where it is possible not to keep a promise.

Lucius Seneca wrote that in every promise and obligation there is an implied clause, which sounds approximately as follows: I undertake to fulfill the promise if I am able and in a position equal to the one at which the obligation arose. In doing so, both parties must make an effort to ensure that the purpose of the contract and benefits to the parties remain unchanged (Seneca 1995, 97).

The idea that a change of circumstances may somehow affect the enforceability of a contract was developed during the Middle Ages due to rather unstable economic con-

[17] All documents are available at EUR-Lex. Accessed July 25, 2022. https://eur-lex.europa.eu/homepage.html?locale=en.

[18] *Aurelii Augustini Opera omnia.* Patrologia Latina, vol. 36: Enarrationes in Psalmos. Accessed September 21, 2021. https://www.augustinus.it/latino/esposizioni_salmi/index2.htm.

ditions. In general, it is often the lack of economic stability that is the impetus for the development of new legal institutions, especially those relating to possible difficulties or impossibility of performance. As the economy struggled with crises, the legal system was forced to adapt to the changing reality. The former principle "*pacta sunt servanda*" was supplemented by "*rebus sic stantibus*".

Medieval theologians, although holding to the idea of the sanctity of the contract, began to speculate about the previously described concept of the implied clause. A collection of ecclesiastical canons compiled in the 12th century, the *Decretum Gratiani*[19], included clauses on the admissibility of oaths and lies of necessity. As a result, there was a general understanding in canon law that the clause "*rebus sic se habentibus*" was an important condition, or even principle, of private law. Moreover, such a clause was considered "implied".

The natural law school evolved differently; in particular, much greater importance was attached to the principle of "*pacta sunt servanda*". For this reason, the possibility of non-performance of obligations due to changed circumstances was seen as an unacceptable violation of this fundamental principle. Thus, a vibrant discussion on this subject arose. Hugo Grotius opposed the recognition of the "*rebus sic stantibus*" clause as an implied clause. In this regard, he pointed out that newly arisen circumstances may be in clear contradiction with the original will of the parties at the time of conclusion of the contract, if it is a change in those contractual obligations which motivated the conclusion of the contract.

Despite the existence of a number of studies and development of thought on the subject, this doctrine did not often apply in practice, since it was not clearly fixed by national legal acts. Until today, a number of jurisdictions use this instrument in a very limited way.

As for international law, clausula *rebus sic stantibus* is deemed to be one of the oldest norms of customary law (Lauterpacht 2004, 14–15). Its variations are set forth in a number of international legal acts. Generally, in international law, this legal institute is called "hardship". Various acts provide for different types of legal consequences of hardship as follows:

— termination or withdrawal from a contract;

— amendment of a contract by court;

— duty to renegotiate a contract;

— exemption from liability in damages (this possible legal consequence is currently the subject of considerable debate).

The first variation is presented in Art. 62 (1) of the 1969 Vienna Convention on the Law of Treaties[20]:

> A fundamental change of circumstances which has occurred with regard to those existing at the time of the conclusion of a treaty, and which was not foreseen by the parties, may not be invoked as a ground for terminating or withdrawing from the treaty unless:
>
> (a) the existence of those circumstances constituted an essential basis of the consent of the parties to be bound by the treaty; and
>
> (b) the effect of the change is radically to transform the extent of obligations still to be performed under the treaty.

[19] Accessed July 25, 2022. https://gratian.gratian.org.

[20] Accessed July 25, 2022. https://legal.un.org/ilc/texts/instruments/english/conventions/1_1_1969.pdf.

This provision is only applicable when terminating or withdrawing from the treaty, but not modifying it.

Another version of hardship is provided in Art. 6.2.3 of the UNIDROIT Principles of international commercial contracts 2016 ("UNIDROIT Principles"). It encompasses three of the four above types of legal consequences of hardship. According to the UNIDROIT Principles, in case of hardship a party to a contract may request renegotiations. Solely if the parties do not reach an agreement in the course of negotiations, the court may terminate or adapt the contract.

Similar provisions are specified in the Principles of European Contract Law[21].

As for the last type of legal consequences of hardship (exemption from liability in damages), it is currently subject to scientific discussion. This is due to the fact that this effect of hardship indirectly follows from the provisions of Art. 79 of the 1980 United Nations Convention on Contracts for the International Sale of Goods. The application of Art. 79 to hardship is disputable, as it applies primarily to force majeure. At the moment, the prevailing opinion is that this provision covers not only force majeure events, but also hardship[22]. Therefore, the author named this type of legal consequence of hardship among others.

Below the author elaborates in more detail on this doctrine within the framework of Russian legislation and court practice.

2.2.2. Clausula rebus sic stantibus in Russian legislation and court practice

Clausula *rebus sic stantibus* was unknown to the Russian national legal system until the introduction of the Civil Code of the Russian Federation[23] ("Russian Civil Code") in 1994. To begin with, Russia built its legal system to a very large extent through legal reception, and consequently, most of legal instruments appeared in Russia after their detailed development and application abroad. Secondly, in the USSR it was actually impossible to develop this doctrine exactly as we know it, since the USSR used to have a planned economy rather than a market one.

At the same time, it is worth noting that there was one provision that had certain similarities with clausula *rebus sic stantibus*: it was possible to terminate or amend an obligation, which was based on certain acts of planning of the national economy, if these acts changed. Obviously, such provisions did not exist in market economies.

Under Russian law, modification or termination of a contract by a court is permitted with reference to Article 451 of the Russian Civil Code. In such a case, one must prove that international economic sanctions constitute a "substantial change of circumstances". The substantial change of circumstances is a legal instrument based on clausula *rebus sic stantibus*.

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[21] *Principles of European Contract Law. Parts I and II. Combined and Revised*. 2000. Eds Ole Lando, Hugh Beale, pp. 322–327. Alphen aan den Rijn, Kluwer Law International.

[22] CISG-AC Opinion No. 20, Hardship under the CISG, Rapporteur: Prof. Dr. Edgardo Muñoz, Universidad Panamericana, Guadalajara, Mexico. Adopted by the CISG Advisory Council following its 27th meeting, in Puerto Vallarta, Mexico on February 2–5, 2020. See also: (Schwenzer 2008, 713–725).

[23] Hereinafter all references to Russian regulations and court practice are given according to the data from the "ConsultantPlus" system. Accessed September 21, 2021. http://www.consultant.ru.

Courts examine this aspect on a case-by-case basis and come to an individual conclusion. However, Art. 451 of the Russian Civil Code establishes certain criteria to determine whether a change of circumstances is substantial. These criteria include the following:

— the parties could not have reasonably foreseen this change of circumstances[24] ("Criterion No. 1");

— the parties would not have been interested in entering into the contract, or would have entered into it on different terms, had they been able to anticipate such a change of circumstances ("Criterion No. 2");

— the occurrence of these events could not have been avoided with a reasonable degree of care and diligence ("Criterion No. 3");

— execution of the contract would upset the balance of interests of the parties, and one of the parties would likely suffer considerable damage or lose what it could have expected at the time the contract was entered into ("Criterion No. 4").

In this case, it is important that the risk of substantial change of circumstances has not been imposed on one of the parties by contract or law ("Criterion No. 5").

Importantly, Russian law favours termination rather than modification of a contract. The court may only change a contract due to substantial change of circumstances in exceptional cases. In order to modify a contract, one must prove that the following additional conditions are met:

— termination of the contract would be contrary to public policy. For example, a contract for repair of a particularly important social facility cannot be terminated due to substantial change of circumstances;

— it will cause damage to the parties that will greatly exceed the cost of performance of the contract on the previous terms. An example of such a situation is a change in the legal regime of a land plot, which does not allow to use the plot in the way stipulated in the contract.

In other cases, if the criteria for termination under Art. 451 of the Russian Civil Code are met, the court will terminate the contract.

If the court decides to terminate the contract due to substantial change of circumstances, it will, at the request of either party, determine the consequences of the termination based on the general rules. However, it must fairly distribute the costs incurred by the parties when executing the contract. For example, the court may rule that one party shall bear costs incurred by the other party under a bank warranty to secure the performance of the contract and the travel costs.

As follows from the above, the legal consequences of a "substantial change of circumstances" in Russia significantly differ from the legal consequences of hardship in international trade law. Not only Russian law does not provide for the duty to renegotiate a contract or exemption of a party to the contract from liability in damages in case of substantial change of circumstances, but it also stipulates an interesting order of imposing legal consequences, namely it favours the termination rather than the modification of a contract. This legal construction is unusual not only from the standpoint of international trade law, but also with regard to other national legal systems, e. g., Switzerland and the Netherlands.

[24] Ruling of the Supreme Court of the Russian Federation No. 18-KG13-70 dated July 30, 2013.

The above Russian approach is reasonably criticised by numerous scientists and practitioners (Ochhaev 2017, 208; Ivanov 2016). Since this discussion would deserve a separate scientific study, the author does not delve into this issue within the scope of this article.

As for the scope of application of clausula *rebus sic stantibus* in Russia, it expands and gets refined over time. At first, the definition and, therefore, the scope of application were very vague. For example, Russian legislation never included a list of circumstances that shall be deemed "substantial" in the meaning of Art. 451 of the Russian Civil Code. However, now, court practice illustrates almost all possible cases, where clausula *rebus sic stantibus* may apply. Court practice is diverse, in particular similar situations of changes of circumstances may sometimes be considered substantial and sometimes not, depending on the case. In particular, courts may recognise the following as substantial change of circumstances:

— decrease of budget financing of a state body which is a party to the contract[25];

— change in the legal regime of a land plot that has been leased to a party to the contract if it can no longer be used for the purpose specified in the contract[26];

— epidemiological situation, introduction of restrictive measures or self-isolation regime, unless otherwise stipulated by the contract or unless otherwise follows from its essence (see Review of specific issues of court practice related to the application of legislation and measures to combat the spread of a new coronavirus infection (COVID-19) in the Russian Federation No. 1 (approved by the Presidium of the Supreme Court of the Russian Federation on April 21, 2020).

In practice, courts generally do not recognise the following changes as substantial:

— deterioration of financial condition of the party, including insolvency[27];

— failure to meet performance deadlines under the contract[28];

— actions by a third party which caused a breach of the contract[29];

— amendments to the law, if they do not affect the execution of the contract[30];

— increased prices for the delivered fuel[31].

As for international economic sanctions, it is difficult to say, whether court practice is positive or negative. Under certain conditions sanctions may be viewed as substantial change of circumstances.

In order to understand whether a court will decide that in a specific case sanctions constitute substantial change of circumstances and, therefore, a contract shall be modified or terminated, it is necessary to look into the previously listed criteria. However, it is worth mentioning, that these criteria are not enough to understand what else impacts court decisions. Therefore, the author performed an extensive analysis of relevant court practice since 2018.

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[25] Case No. A41-35134/2015.

[26] Cases Nos. A79-4088/2015, A46-3991/2016.

[27] Cases Nos. A17-1960/2009, A40-139648/2019, A41-34193/2018, A56-51762/2018, A23-3442/2017.

[28] Case No. A65-24606/2014.

[29] Cases Nos. A41-26466/2015, A40-75563/2015.

[30] Cases Nos. A40-238801/2015, A41-3415/2016, A41-54476/2014.

[31] Cases Nos. A51-6750/2019, A73-21111/2017.

2.2.3. Russian court practice on modification and termination of contracts due to international economic sanctions

Current court practice remains ambiguous, but allows to derive some additional criteria for assessing whether a change of circumstances is substantial or not. Within the framework of this research the author has analysed court practice since 2018 and identified the following main additional criteria:

— correlation between the date of imposition of sanctions and the date of conclusion of the contract (in particular, courts do not recognize sanctions as a substantial change of circumstances if they were already imposed at the time of conclusion of the contract, even if the claimant was not aware of their existence);

— actions on the part of the claimant, demonstrating his good faith, such as initiating negotiations in order to amend the contract, giving notice of a substantial change of circumstances and the impossibility to perform the contract, finding ways to perform the contract despite the substantial change of circumstances.

A closer look at some of the court disputes underlying these criteria is of particular interest.

One of the most high-profile disputes is the *Neighbour's Drilling* case[32]. What is interesting about this case is that the court found the arbitration clause unenforceable due to the imposition of the US sanctions on Instar Logistics LLC ("Claimant"). Importantly, the Claimant is listed on the SDN List, and the respondent, a subsidiary of Neighbor's Drilling International Limited ("Respondent"), is a US person.

The Claimant and the Respondent entered into a master services agreement ("Master Agreement"), dated 2012. In 2016 and 2017, pursuant to the Master Agreement specific agreements, the so-called orders No. 1, No. 5 and No. 7 ("Orders") were entered into, pursuant to which the Claimant arranged for storage of drilling rigs for the Respondent.

The Master Agreement contained an arbitration clause, while the Orders were silent as to applicable law and dispute resolution procedure. Pursuant to the arbitration clause, disputes under the Master Agreement were governed by English law in accordance with the Rules of the International Court of Arbitration of the International Chamber of Commerce ("ICC").

Significantly, the Claimant sent the Respondent a proposal to replace the arbitration clause with a prorogation agreement, which provided for dispute resolution in the Moscow City *Arbitrazh* (Commercial) Court ("ASgM"); the Respondent failed to respond.

The Claimant addressed the ASgM with the following claims:

— amend the Orders to replace the arbitration clause in the Master Agreement with a prorogation agreement, which would for dispute resolution in the ASgM in accordance with Russian law;

— to reimburse the debt and an interest rate for the use of funds[33].

The court concluded that Russian law applied to this Master Agreement and the arbitration clause should not apply to disputes arising from the Orders. In addition, the court found that the imposition of sanctions constituted a substantial change of circumstances for the following reasons:

[32] Case No. A40-149566/2019.

[33] This claim has been assigned to a separate proceeding — Case No. A40-196570/2019.

— when entering into the Master Agreement and the Orders, the parties could not have foreseen that sanctions would be imposed on the Claimant;

— the Master Agreement and the Orders would not have been entered into had the restrictions been in place;

— execution of the provisions of the Orders without modification would result in loss on the Claimant's side, as he would not receive payment for services rendered to the Respondent;

— the merits of the Master Agreement and the Orders do not suggest that the Claimant bears the risk of a change of circumstances.

A crucial conclusion of the court was as follows: the ASgM decision cannot be enforced anywhere but in Russia, since all bank transfers towards the Claimant are blocked because all the financial transactions go through the correspondent accounts of banks controlled by the US Federal Reserve System. Moreover, the court noted that the actual enforcement of the Claimant's rights and interests can now only take place within the territory and jurisdiction of Russia.

In addition to the previously analysed dispute, there is a number of other cases, where Russian courts also faced this issue. For example, one should pay attention to the *KhimTekhImport* case[34].

The Federal State Budgetary Institution "Federal Center for Quality and Safety Assessment of Grain and Grain Products" ("Claimant") filed a claim against KhimTekhImport LLC ("Respondent") demanding the payment of penalties for delay in performance under a supply contract. The defendant argued that it was impossible to deliver the goods on time due to an imposition of the US sanctions.

The court of the first instance rejected the Respondent's argument about the impossibility of delivery in connection with the imposed sanctions, because the supply contract was concluded in October 2018, i. e. quite a while after the imposition of the mentioned sanctions. Hence, the Respondent was aware of the existence of such circumstances at the time of conclusion of the contract: "The court found that the ban on the export of goods manufactured in the US was imposed in 2014. However, the contract was concluded on October 18, 2018, i. e. long after the imposition of the said sanctions".

Another important point was that the Respondent has made efforts to mitigate the negative consequences of the sanctions imposed: "The court also takes into account the fact that the Respondent took measures to replace the equipment under the contract with similar one due to the impossibility of delivery of the original equipment…"

The appellate court came to the same conclusion.

Courts come to similar conclusions in a number of other cases, including cases Nos. A40-103532/2019, A53-12320/2020, A56-106805/2020. Thus, the court practice demonstrates that the application of this doctrine is often restricted by numerous criteria and preconditions. This is primarily due to the fact that the absence of restrictions could violate the principle "*pacta sunt servanda*" and raise doubts as to the binding force of contractual obligations.

It might be important to note that there is no strict correlation between the type of sanctions imposed and the probability of the recognition of these sanctions as a substantial change of circumstances by a court. This conclusion was reached by the author based

[34] Case No. A40-4541/2020.

on the thorough analysis of court practice. Importantly, out of all the cases since 2018, only 14 indicate what kinds of sanctions were imposed. Other cases included solely general references to the imposed sanctions, e. g. "EU sanctions" or "US sanctions". These figures do not allow any precise conclusions to be drawn. Nevertheless, the author reviewed all these cases and found the following:

— out of 7 cases with regard to US and EU blocking sanctions, two are in favor of the party referring to a substantial change of circumstances[35];

— out of 7 cases with regard to US and EU sectoral sanctions, three are in favor of the party referring to a substantial change of circumstances[36].

Nevertheless, the author believes that the type of imposed sanctions is of great importance. In each particular case, the court determines what kind of restrictive measures were imposed in order to understand whether it in fact affected the performance under the contract. The court has to analyse this matter on a case-by-case basis. However, this cannot be considered a separate criterion because this issue is fully covered by Criterion No. 2. Therefore, the author suggests providing a more specific and detailed description of this criterion with respect to sanctions as follows:

> Criterion No. 2: The parties would not have been interested in entering into the contract, or would have entered into it on different terms, had they been able to anticipate such a change of circumstances, *because of the impact on business relations between the parties of the specific sanctions imposed with respect to one of the parties to the contract*.

2.3. Hypothesis: possibility to modify or terminate a contract due to international economic sanctions is subject to a closed list of criteria

The author raises the hypothesis, that the possibility to modify or terminate a contract under Art. 451 of the Russian Civil Code due to international economic sanctions could be based on a closed list of criteria. In case this assumption is correct, it is also possible in practice to predict whether the court will refuse to amend or terminate a contract, as well as envisage all the necessary provisions in this contract in advance and adjust one's behaviour so as to increase the probability of the favourable court ruling.

As a rule, the list of conditions is deemed to be limited to the five criteria specified in Art. 451 of the Russian Civil Code, namely the Criteria Nos. 1–5.

This understanding is a traditional one. The author does not question these criteria, but tries to derive new, more precise ones related specifically to international economic sanctions. As mentioned above, there are certain conditions of applicability of Art. 451 of the Russian Civil Code formed by relevant court practice.

The first one states that a contract must be concluded before the date of imposition of sanctions. Undoubtedly, this condition is directly linked to the Criterion No. 1, which states that it is crucial that the parties to a contract could not have reasonably foreseen the imposition of sanctions. Logically, it is only possible if there were no sanctions imposed on the date of conclusion of the contract.

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[35] Cases Nos. A40-149566/2019, A40-37214/2020, A56-3536/2020, A56-45960/2020, A40-318583/2018, A40-10033/2019, A64-2548/2018.

[36] Cases Nos. A40-10033/2019, 33-35920/2019, A40-14071/2020, A40-46243/2019, A40-294780/2019, A40-241276/2020, 33-4241/2021.

Moreover, the Supreme Court[37] has explicitly stated that in applying Art. 451 of the Civil Code, it is necessary to determine the following circumstances:

— the existence of a substantial change of circumstances;

— the time of its occurrence;

— the possibility to reasonably foresee this change.

Having analysed the court practice since 2018, the author did not stumble upon any cases that would contravene this criterion. Since the court practice is strictly adhered to it, the author believes that it can be considered relevant. For the purposes of categorisation, the author hereafter refers to this criterion as "Criterion No. 1A".

As described previously, there is at least one more condition of applicability of Art. 451 of the Russian Civil Code formulated on the basis of the court practice. This criterion entails that the claimant has to demonstrate his good faith by means of certain actions.

The so called "*bona fides*" principle is one of the pillars of Russian civil law. For this reason, it would be incorrect to say that it is a unique criteria applicable solely to the above described situations. The basic rule is specified in Art. 10 of the Russian Civil Code: the *bona fides* of the participants and the reasonableness of their actions are presumed. As a rule, the burden of proof lies on the one who challenges someone else's good faith[38]. Upon evidence showing that a person has acted in bad faith, this person then bears the burden of proving the good faith and reasonableness of his or her actions[39].

In assessing the actions of the parties as done in good or bad faith, one should proceed from the behaviour expected of any person who takes into account the rights and legal interests of others and assists them, including obtaining the necessary information[40].

As we can see, this principle appears to be very similar to the category of justice and fairness (Gernhuber 1983, 764). Importantly, it is also connected with the principle of equality of the parties to a contract.

The *bona fides* principle provides guidance as to whether a contract really needs to be amended or terminated. So, in case one of the parties abuses its rights and is in fact able to perform under the contract but tries to benefit from the application of the "substantial change of circumstances" doctrine, this principle should prevent such a party from fulfilling its intentions.

The principle of equality of the parties to a contract also provides a guideline as to whether the "substantial change of circumstances" doctrine applies.

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[37] Ruling of the Supreme Court of the Russian Federation No. 18-KG13-70 dated July 30, 2013.

[38] Ruling of the Supreme Court of the Russian Federation No. 5-KG15-92 dated September 1, 2015.

[39] Review of court practice of the Supreme Court of the Russian Federation No. 2 (2015) (approved by the Presidium of the Supreme Court of the Russian Federation on June 26, 2015).

[40] Decree of the Plenum of the Supreme Court of the Russian Federation No. 25 dated June 23, 2015 "On the application by courts of certain provisions of Section I of Part One of the Civil Code of the Russian Federation", para. 1; Rulings of the Supreme Court of the Russian Federation No. 51-KG20-12-K8, 2-5/2018 dated February 2, 2021, No. 18-KG19-147 dated January 21, 2020, No. 306-ES18-16390, A65-31592/2017 dated February 11, 2019, No. 50-KG17-27 dated January 9, 2018, No. 49-KG16-18 dated September 20, 2016, No. 78-KG16-36 dated August 30, 2016; Review of court practice of resolving cases on disputes arising in connection with participation of citizens in shared construction of apartment buildings and other real estate (approved by the Presidium of the Supreme Court of the Russian Federation on July 19, 2017).

Courts usually take into account whether there were any actions on the part of a party, demonstrating his or her good faith. For example, in the previously mentioned *Neighbour's Drilling* case[41] the court took into consideration the fact that the Claimant sent the Respondent a proposal to replace the arbitration clause with a prorogation agreement, while the Respondent did not express an intention to cooperate.

Although this condition of applicability of Art. 451 of the Russian Civil Code is linked to the Criteria Nos. 3 and 4, the author considers appropriate to separate it out as "Criterion No. 6".

Therefore, the author identifies the following main criteria:

— Criterion No. 1: The parties could not have reasonably foreseen that circumstances would substantially change;

— Criterion No. 1A: The contract in question was concluded before the date of imposition of sanctions;

— Criterion No. 2: The parties would not have been interested in entering into the contract, or would have entered into it on different terms, had they been able to anticipate such a change of circumstances, because of the impact on business relations between the parties of the specific sanctions imposed with respect to one of the parties to the contract;

— Criterion No. 3: The occurrence of these events could not have been avoided with a reasonable degree of care and diligence;

— Criterion No. 4: Execution of the contract would upset the balance of interests of the parties, and one of the parties would likely suffer considerable damage or lose what it could have expected at the time the contract was entered into;

— Criterion No. 5: The risk of substantial change of circumstances has not been imposed on one of the parties by contract or law;

— Criterion No. 6: The claimant demonstrated his good faith by means of certain actions.

Having analysed the relevant court practice since 2018, the author confirms that courts assess whether facts of a case meet the above criteria.

3. Conclusions

In Russia modification or termination of a contract by a court is permitted with reference to Art. 451 of the Russian Civil Code. In such a case, one must prove that international economic sanctions constitute a "substantial change of circumstances", which is based on clausula *rebus sic stantibus*.

The Russian Civil Code does not explicitly provide for possibility to modify or terminate a contract due to sanctions. According to the performed analysis of the court practice, modification or termination of a contract due to imposition of sanctions is quite a rare phenomenon in Russia. Nevertheless, this possibility is real. Therefore, it is utterly important for a claimant to understand under which circumstances this could be possible.

If a party to a contract intends to mitigate the risk of possible negative consequences related to the sanctions, which could be imposed on a counterparty (particularly blocking

[41] Case No. A40-149566/2019.

sanctions, such as inclusion in the SDN List or in the EU Designated Persons List), it is important to focus on two main aspects:

— thorough due diligence;

— attention to the relevant provisions of the contract in question.

Importantly, it is possible to exclude application of Art. 451 of the Russian Civil Code by the contract.

Should there be any doubt regarding the sanctions status of a party to the contract, the thorough due diligence is a sufficient element of the risk mitigation strategy. It is also necessary to review the contract itself to avoid the possibility of contractual exclusion of application of Art. 451 of the Russian Civil Code.

The author would also suggest including the so called "sanctions clause". The nature of such a clause is similar to an anti-corruption clause (Primakov 2018, 10). A sanctions clause is a provision in a contract aimed at providing a guarantee that the counterparty is not subject to sanctions. The clause may stipulate the procedure to be followed should sanctions be imposed on the counterparty, including the obligation to immediately notify the other party to the contract. Moreover, it is advisable to explicitly provide for the possibility to modify or terminate the contract in such a situation. The sanctions clause may read as follows: "The parties hereby represent and warrant that they will not be using the goods, services, or other means received in accordance with this contract in order to circumvent the provisions of sanction legislation applicable to the parties' operations and, in particular, to help third persons to circumvent sanction legislation".

Currently, there are several disputable issues with respect to sanctions clauses, e. g. whether such a clause contradicts public interests or legal order in Russia, or whether such a clause somehow puts one of the parties to the contract at a disadvantage. In practice, sanctions clauses are included in contracts between a Russian company and a foreign company subject to US or EU legislation or their subsidiaries. Most often, in the case of the imposition of sanctions affecting the business relations of the parties, they initiate negotiations in order to mitigate the possible negative consequences of the imposed sanctions. The court is rarely engaged.

In this regard, it is interesting to note the well-known Siemens case[42]. Generally, this case is the only one where the court provided an extensive analysis of the question of sanctions clauses admissibility. For the purposes of this study, it is not necessary to go into the details of the case. Importantly, the court took the position that the principle of freedom of contract allows the parties to include a sanctions clause in the contract. The court additionally pointed out that the trade restrictions listed in the clause constitute a factor that may affect international trade and foreign economic relations. Taking into account such restrictions allows participants adhere to the rules of law.

In general, to reduce the risks associated with a substantial change of circumstances, it is necessary to treat the contract carefully and attentively, to verify all its provisions and to specify the course of action in case of any impediment to the performance of the contract, including sanctions.

[42] Cases Nos. A40-126531/17-68-571 and A40-171207/17-111-1562.

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Received: September 26, 2021
Accepted: September 5, 2022

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