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Swiss Embargos and their Impact on Contracts Governed by Swiss Law Illustrated by the Swiss Sanctions against Iran

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Introduction: Many international commercial contracts (such as e.g., construction, distribution, sale and purchase) are governed by Swiss (substantive) law as per a choice of law provision. Often the choice of law is made in combination with an arbitration clause referring disputes to arbitration in Switzerland. The effect of international sanctions on commercial contracts has become a burning issue once more due to the sanctions adopted by the international community against Iran. The present note briefly analyses the Swiss regime of sanctions against Iran, and some contractual issues that might arise from contracts governed by Swiss substantive law. In 2010, the trade volume between Iran and Switzerland amounted to CHF 741 million, with machinery and equipment as the predominant export to Iran. The trade volume of contracts related to business transactions with Iran and governed by Swiss substantive law is unknown, but it is safe to assume that it is a multiple of the above amount.

In June 2010, the United Nations Security Council adopted new and tighter sanctions against Iran aiming at stopping Iran's nuclear program (UN Security Council's resolution 1929 of 9 June 2010). Based on this resolution the United States, the European Union and several other important countries (including Australia, Japan, Canada) implemented even broader sanctions against Iran. Those sanctions consist of strict economic and financial embargos banning imports from and exports to Iran, and also contain a blacklist of Iranian companies and individuals with whom trade is prohibited.

In August 2010, Switzerland transposed the UN resolution into Swiss national law by amending the existing Federal Ordinance of 14 February 2007 on Measures against the Islamic Republic of Iran. On 19 January 2011 Switzerland also tightened its sanctions against Iran by adopting a new Federal Ordinance (the "Ordinance") which replaced the 2007 Ordinance. It came into effect on 20 January 2011 and, in principle, aligns Switzerland's position with that of the UN.

The (new) Swiss Sanctions: The Federal Embargo Act ("EmbA") is the legal basis for Swiss sanctions against foreign countries. Pursuant to Articles 1 and 2 EmbA, the Swiss Government can enact coercive measures imposed by the United Nations, by the OSCE, or by Switzerland's most important business partners aiming to ensure the respect of public international law, namely compliance with human rights.

The Ordinance imposes a strict ban on export of so called dual use goods, technologies, and software (i.e. products and technologies normally used for civilian purposed which may also have a

military application). Furthermore, since it is assumed that Iran finances the enrichment of uranium through the revenues of its oil and gas sector, the export restrictions also encompass goods that may be used in this sector. Furthermore, any financing of or shareholdings in Iran's oil and gas sector is prohibited.

The Ordinance also affects Switzerland's financial sector and contains e.g. a prohibition for Swiss (re-)insurance companies to contract with Iranian individuals or entities. Likewise, the law proscribes Swiss banks from transacting with Iranian banks. Furthermore, any money transfer to or from an Iranian individual or company over CHF 10'000 must be reported to Switzerland's State Secretariat for Economic Affairs (the "SECO"); transfers exceeding CHF 50'000 even require a prior authorization from the SECO. The Swiss financial institution executing the transfer must file the request for authorization. Where that institution is not based in Switzerland, the Swiss beneficiary or the party ordering the money transfer must report it and seek prior authorisation. The SECO will grant a request if the money transfer does not violate the Ordinance or any other Federal Acts applying to the proliferation of armaments. Finally, the Ordinance also provides for a long blacklist of Iranian individuals and companies whose assets in Switzerland have been frozen and with whom any kind of transaction is prohibited.

Any violation of the Ordinance is punishable by imprisonment of up to one year or a fine of up to CHF 500'000.

Some Issues Arising under Swiss Law:

a. No bar to arbitration- The effect, if any, of a sanction on arbitration agreements is determined by the (arbitration) law at the place of arbitration. The nullity of the contract containing the arbitration agreement does not necessarily lead to the nullity of the arbitration agreement. Under Swiss arbitration law, all claims with a monetary value are arbitrable (Article 177 Private International Law Act), irrespective of whether the underlying contract is void or enforcement would be prohibited by international sanctions (Decision of the Swiss Federal Supreme Court Fincantieri v OTO Melara in ASA Bulletin 1993, 58 regarding sanctions against Iraq).

b. Illegality/Impossibility- Even if arbitration is possible, the claim may fail on the merits. Article 20 of the Swiss Code of Obligations ("CO") sets forth three grounds on which a contract can be null and void: First, the contract is impossible to perform, second it has an illegal content, or third it violates bonos mores. A contract is illegal if its content, its conclusion or its purpose is incompatible with mandatory provisions of Swiss law. A contract must be lawful at the moment the parties conclude it. As a consequence, even if a dispute arises at a time when the contract is no longer unlawful (e.g. because the embargo was lifted), the contract remains null and void (Decision of the Swiss Federal Supreme Court 102 II 401 of 21 December 1976). This is, however, controversial and some scholars opine that in such circumstances, the illegality is cured (Claire Huguenin in Basle Commentary to the Swiss Code of Obligation I, 4th edition 2007 to Article 19/20 CO, N 16 with further references).

As to the impossibility of performance, it might arise from factual or legal circumstances. It is therefore not necessary that a given performance obligation under a contract be factually impossible so long as the law prohibits such performance, provided that the law is of permanent nature. Situations of temporary impossibility do not cause the nullity of the contract but are considered as being a situation of default under Swiss law. Most embargos are of temporary nature and therefore tend to cause default situations rather than a permanent impossibility. However, in a

decision dating back to 1955, the Swiss Federal Supreme Court accepted embargos as possible causes for (permanent) legal impossibility (Decision of the Swiss Federal Supreme Court 81 II 613 of 13 December 1955). As a consequence, embargos such as that provided for by the Ordinance may give rise to a legal impossibility.

c. Supervening impossibility- If a contract becomes unlawful after its conclusion ("supervening impossibility") by operation of a law enacted subsequently, the law cannot retroactively invalidate the contract (Decision of the Swiss Federal Supreme Court 100 II 105 of 28 March 1974). While impossibility ab initio under Article 20 CO renders a contract null and void ex tunc, an intervening impossibility merely exempts the obligor from its performance obligations as of the moment when the impossibility intervenes (Article 119 CO). Parties are free to include risk allocation clauses in their contract which apply in the event of international sanctions or provide for a mere suspension of performance in a force majeure clause (instead of extinction of the obligation as provided for by Article 119 CO).

As is the case with initial impossibility, likewise a supervening impossibility must be of a permanent nature, which may not hold true for most embargos. Nevertheless, as already outlined, Swiss courts have accepted payment restrictions imposed by Switzerland as a potential cause of legal impossibility. In a case involving a Swiss (national) embargo on exports of certain types of machines that could be potentially used in the production of nuclear weapons, the Swiss Federal Supreme Court ruled that the enactment of embargo qualified as a supervening legal impossibility within the meaning of Article 119 CO. The Supreme Court specified, however, that the seller of such goods may still be held liable for any damages resulting from non-performance if he knew or could have known about the future embargo at the time the contract has been entered into (Decision of the Swiss Federal Supreme Court 111 II 352 of 3 September 1985).

As stated, certain Swiss legal scholars consider that a temporary embargo does not constitute a legal or permanent impossibility within the meanings of Articles 20 and 119 CO, respectively, but merely a default situation. In this context, the award in ICC arbitration no. 7575 is of interest (Reported in Journal de droit international 2010, p. 1377). As the relevant embargo (against former Yugoslavia) was no longer in place, the arbitral tribunal found that there was no obstacle to the future performance of the contract. Another interesting question examined by the arbitral tribunal was whether interest continued to accrue during the embargo. The tribunal considered that interest was due and served to redress currency devaluation.

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