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Choice of Swiss Law – No Escape Route To Avoid Application of International Sanctions

The parties' designation of Swiss substantive law as the law governing their contractual relationship does not definitely exclude an application of mandatory rules of foreign or supranational law. In a recent decision, the Swiss Federal Supreme Court held that a transaction violating a UN embargo on delivery of weapons is also contrary to good morals and therefore invalid under Swiss substantive law.

Introduction

It is a generally accepted principle of law that the parties to an international commercial transaction are free to choose the law governing their contractual relationship. Many non-Swiss parties in international commercial transactions for instance provide for the application of Swiss law to their contract. However, a growing number of rules of law demand to be respected or applied irrespective of the law chosen by the parties. Such rules generally aim to protect political, economical or social interests of a particular state or a community of states. While in the conception of the enacting state or the international body these rules are mandatory and have to be taken into consideration even by a foreign court or an arbitral tribunal seated in another country, it is the jurisdiction of the latter deciding whether these rules will actually be applied.

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The questions of interference of foreign mandatory rules in particular arise in connection with trade sanctions and embargoes, competition laws or exchange control regulation. May the parties, for example, circumvent a UN sanction or avoid EU competition law by submitting their contractual relationship to Swiss Law and Swiss jurisdiction or arbitration, as Switzerland is not (yet) a member state of the UN or the EU? Or can, quite to the contrary, a respondent invoke in Swiss litigation or arbitration proceedings that the agreement, based on which the claimant is asking for relief, is null because violating a UN-embargo or contradicting EU competition laws?

Approach of the Swiss Private International Law

Swiss courts have traditionally been reluctant to apply foreign mandatory rules, thus giving preference to the parties' autonomy and rejecting to hear foreign public interest considerations. Nevertheless, under the conception of the Private International Law Act of 1987 ("PIL") a mandatory provision of a foreign law may even be taken directly into account, despite the parties opting for Swiss substantive law, if there exists (i) clear evidence that the foreign legal provision intends its international, mandatory application, (ii) a close connection between the case at issue and the foreign legal provision, (iii) a preponderant interest, deserving protection pursuant to the Swiss conception of law, of one of the parties that the foreign mandatory provision be taken into account, and (iv) consistency of the result of the foreign legal provision's application with the Swiss conception of law. However, it seems that the repercussions of Art. 19 PIL on Swiss court practice has been rather limited. Even in the case summarized below, the courts did not revert to this provision.

Arbitration and Interference of Foreign Mandatory Rules

Swiss arbitral tribunals, to the contrary, are regularly confronted with the question whether and in which cases mandatory foreign rules may or even ought to be applied over and above the law chosen by the parties. Art. 19 PIL is not directly applicable to international arbitration in Switzerland and arbitration practice has developed its own criteria. There is a growing consensus that the so-called trans-national public policy should be taken as a benchmark for granting an extraterritorial effect to rules of law. It is largely agreed that national prohibitions fighting corruption, smuggling, drug traffic, arms trafficking or trade of goods belonging to the cultural heritage are, in principle, part of the

trans-national public policy and have to be taken into account by the arbitrators, though the issue of interference of foreign mandatory rules remains one of the most debated and controversial topics in international arbitration.

With regard to the interference of foreign antitrust law, the prevailing view today is that a tribunal sitting in Switzerland generally has to take into consideration the relevant antitrust laws; and this not only if pleaded by a party as a defence but even ex officio. Accordingly, parties aiming to avoid antitrust sanctions under the laws in force at the place where competition is affected cannot count on the "assistance" of the Swiss law respectively the Swiss arbitral tribunal.

Recent Swiss Supreme Court Decision

In a decision of March 2001 the Federal Supreme Court had to decide on the impact of the resolution Nr. 713 of the UN Security Council, establishing an embargo on all deliveries of weapons and military equipment to (former) Yugoslavia in 1991, on the validity of a promissory note securing the payment for the sale of weapons to Croatia. While the claimant requested payment, respondent held that the promissory note was null because the underlying transaction, i.e. the arms deal, was contrary to the UN embargo and therefore illegal and contra bonos mores according to Art. 20 of the Swiss Code of Obligations ("CO").

The Federal Supreme Court asserted that a Resolution of the Security Council has no legally binding effect on Switzerland not being a UN member state. The Swiss regulation on arms trade was not applicable either, since the case had no connection to Switzerland apart from the fact that the promissory note had been made subject to Swiss law. Accordingly, the transaction did not infringe Swiss law as such. The Federal Supreme Court confirmed, however, that a violation of foreign mandatory rules could result in a transaction contra bonos mores if these rules are of such importance that – according to the general conception of all civilised states – their violation would endanger the domestic public order. In order to prevail over the principle of freedom of contract the foreign rules must protect fundamental and essential interests of mankind and individuals. The court considered it questionable whether a delivery of weapons to a region in turmoil is per se contrary to the ethical and moral conception in Switzerland since the use of force could, under certain circumstances, be legitimate as self-defence. It held that the transaction in question, having no direct connection to Switzerland, must, however, also be scrutinized with regard to the trans-national public policy: The UN Charter's fundamental principle to renounce from the use of force in international relations is part of the trans-national public policy, thus basically prohibiting the delivery of weapons to regions in or on the edge of war. As the UN-embargo on weapon delivery over the territory of (former) Yugoslavia constitutes a concretion of this principle, the embargo is part of the trans-national public policy. Thus, the Federal Supreme Court concluded that the arms transaction in question is in evident opposition to good morals under Swiss law. The absolute nullity of the arms transaction entailing the invalidity of the promissory note, claimant's claim for payment was rejected.

Conclusion

Though Switzerland is not (yet) a member state to some very important international or supranational organizations, Swiss courts and arbitral tribunals take into account trans-national public policy. Choice of Swiss law and jurisdiction of Swiss courts or arbitral tribunals may therefore not be improperly used as an escape route to avoid applicability of mandatory rules of foreign or supranational laws.

NewsLetter

The ww&p **News**Letter provides comments on new developments and significant issues of Swiss law. These comments are not intended to provide legal advice. Before taking action or relying on the comments and the information given, adressees of this **News**Letter should seek specific advice on the matters which concern them.

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