

Construction - Switzerland

Impact of embargoes on construction contracts - Swiss sanctions against Iran

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Introduction

The list of countries affected by international sanctions and embargoes is getting longer. The sanctions imposed on such countries - which include Libya, Syria, North Korea and Iran - are also gradually becoming more extensive and restrictive.

Switzerland has adopted a number of its own sanctions against Iran by transposing the UN sanctions and some – but notably, not all⁽¹⁾ – of the further EU and US sanctions into national law.

How sanctions affect construction contracts

A breach of Swiss sanctions can lead to criminal penalties, which include imprisonment up to one year or a fine of up to Sfr500,000.

The scenarios in which Swiss sanctions may affect construction contracts governed by Swiss law include the following:

- One of the parties is blacklisted;
- The construction contract concerns works falling under the restrictions imposed by the sanctions - for example, equipment used in the petrochemicals industry; or
- The transaction is subject to Swiss sanctions and a Swiss bank or insurance company is involved as financier or insurer, and/or payment of the agreed remuneration under the construction contract is to be made from, to or through a Swiss bank.

Applicability of sanctions

Due to Switzerland's perceived status as a neutral venue, and the relative accessibility of the Code of Obligations to foreign users as a result of its clear and concise nature and availability in several languages, many international construction contracts are governed by Swiss law by way of a choice of law clause. Under Swiss law, the parties to an international construction contract are, in principle, free to agree on the governing law (Article 116 of the Private International Law Act). Unless specified otherwise, the parties' choice of law extends to all legal provisions of the chosen jurisdiction, regardless of their source (eg, laws, regulations, ordinances, case law and doctrine), and regardless of whether they are qualified as provisions of public or private law. By choosing Swiss law, the parties therefore agree to the applicability of Swiss sanctions.

The parties' freedom to choose the applicable law also allows them, in principle, to exclude the applicability of certain provisions. However, despite such an exclusion, a Swiss court or arbitral tribunal seated in Switzerland may apply mandatory provisions of Swiss law or take into account the mandatory provisions of any other jurisdiction with a close link to the situation before it, provided that such provisions form part of Swiss or international public policy (Articles 18 and 19 of the Private International Law Act). Accordingly, if parties attempt to circumvent Swiss sanctions by agreeing on a law other than Swiss law, or by specifically excluding their applicability in their choice of law clause, a Swiss court or arbitral tribunal with a seat in Switzerland might still apply Swiss sanctions (or at least take them into account). An exclusion of mandatory sanctions might also be found to be null and void on the grounds that it is tantamount to an abuse of law (Article 2 of the Swiss Civil Code). However, these issues do not appear to have been addressed by the Swiss courts or the Swiss seated arbitral

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tribunals.

Construction contracts

From the point of view of Swiss substantive law, it is important to distinguish cases in which a contract for works which is affected by sanctions was entered into before the enactment of the relevant sanctions from cases in which it was entered into after the enactment of the sanctions.

Initial illegality or impossibility

Pursuant to Article 20 of the Code of Obligations, any contract may be found null and void if it:

- is impossible to perform;
- has illegal content; or
- violates *bonos mores*.

A contract for works governed by Swiss law which is in breach of Swiss sanctions might be invalid on all three grounds.

First, since Swiss sanctions are mandatory in nature, any breach would be considered to be illegal and would entail the nullity of the contract or, under the principle of partial nullity, of a specific obligation. Second, since impossibility within the meaning of Article 20 may arise from factual or legal circumstances, performance of the contract need not be factually impossible; it is sufficient that performance is unlawful. Finally, a contract is against good moral if, for instance, its content is in breach of Swiss public policy (which might be the case if it is in breach of an embargo).

The critical date for determining the illegality of a contract under Article 20 is the moment of its conclusion. Therefore, if a contract for works was entered into before the enactment of the relevant sanction, it cannot be null and void under Article 20 (its performance may, however, be considered impossible). In addition, even if a dispute arises at a time when the contract is no longer unlawful (eg, because the embargo was lifted), the contract remains null and void.⁽²⁾ However, this view is controversial and some scholars are of the opinion that in such case, the impossibility would be cured and the contract would be enforceable.⁽³⁾

In order to be null and void, pursuant to Article 20, the circumstances resulting in illegality or impossibility must be permanent. Mere temporary illegality or impossibility does not, in principle, entail the nullity of the contract, but is considered under Swiss law to amount to a default (with the consequence that the debtor of the obligation affected is or remains liable).

Supervening impossibility

If a contract becomes unlawful as a result of a law enacted after its conclusion (supervening impossibility), the contract will not be considered null and void (*ex tunc*) pursuant to Article 20,⁽⁴⁾ but the supervening impossibility will exempt the parties from performance of their obligations from the moment it arises, resulting in the contract being terminated *ex nunc* (Article 119).

As is the case for initial impossibility, a supervening impossibility must be permanent in nature, which may not be the case for most embargoes. Nevertheless, the Federal Supreme court qualified a Swiss export ban on certain types of machinery used for the production of nuclear weapons as (permanent) legal supervening impossibility within the meaning of Article 119. However, the court held that the contractor may still be found liable for damages resulting from its non-performance of the contract if, at the time the contract was entered into, it knew or should have known about the future embargo.⁽⁵⁾

In other words, if the construction works become impossible within the meaning of Article 119 due to an embargo enacted after conclusion of the contract for works, the parties are released from their obligations and the contract is terminated *ex nunc*. If the owner has already paid for works which were not performed, it would have a claim for restitution based on the principle of unjust enrichment (Article 60 of the code).

As to the contractor's right to remuneration for works performed under the construction contract before the supervening impossibility, Article 378 - a provision of Swiss construction law - provides that where the completion of works becomes impossible due to circumstances which are attributable to the owner, the contractor remains entitled to compensation for expenses occurred in the performance of the contract, and for remuneration for works which have already been performed.

However, in order for Article 378 to be applicable in the context of an embargo, the risk that an embargo will be enacted must be found to lie with the owner. The issue of where such a risk lies, in the absence of an agreement of the parties, cannot be answered generically, but depends on the circumstances at hand. Based on an old court decision, commentators have, for instance, taken the view that the risk of a construction ban being imposed on the site where the work was to be built lies, as a

rule, with the owner.⁽⁶⁾ As a consequence, in such a situation the contractor is, in principle, released from its obligation to build the house, but remains entitled to compensation for expenses incurred and for (partial) compensation for works already performed. This rule might be applied by analogy to a situation in which an embargo prevents performance of the works. However, this remains to be clarified by courts.

Under Swiss law, the parties are free (and, as a rule, well advised) to take out insurance policies and/or include risk allocation clauses in their contracts for works, and/or to specifically address issues related to embargoes in the contract. Parties could, for instance, stipulate that in the event of an embargo, the contract will be merely suspended, but not terminated, with certain safeguards to ensure that a suspension does not continue for an unreasonable period of time; or that the contract can be terminated if required by an insurance policy. The parties might also agree that the owner will be liable for the contractor's suspension costs, such as the costs of continued mobilisation. However, whether contractual provisions of this type could be implemented would naturally depend on the terms of the embargo, which might prohibit such standby works.

If the owner is the state or an entity controlled by the state which is subject to the embargo affecting the contract, the contractor might argue that the state brought the predicament on itself, and that it cannot rely on a self-inflicted impossibility to the contractor's detriment. However, it is unlikely that this argument would succeed in the local courts of that state.

Breach of a foreign, non-Swiss embargo

Performance of a construction contract may also be affected by foreign, non-Swiss mandatory law, such as US or EU sanctions. As a rule, a contract breaching foreign mandatory law would not be considered illegal or against good morals within the meaning of Article 20. However, if and to the extent that the foreign sanctions effectively frustrate performance, such a contract might nevertheless be found to be null and void on the basis of Article 20 (in case of initial impossibility), or a party might be released from performance pursuant to Article 119 (in case of supervening impossibility).

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Endnotes

(1) In particular, not the most recent general ban on oil and gas trades and financial transactions.

(2) Federal Supreme Court, 102 II 401, December 21 1976.

(3) Claire Huguenin in *Basler Commentary to the Code of Obligation I*, 4th edition 2007 to Article 19/20, N 16 with further references.

(4) Federal Supreme Court, 100 II 105, 28 March 28 1974.

(5) Federal Supreme Court, 111 II 352, September 3 1985.

(6) *Gauch, Der Werkvertrag*, 5th edition, N 724 ff, with reference to Federal Supreme Court Decision 26 II 246, July 13 1900.

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