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International sanctions

Refusal to execute a client's instruction

Par Sébastien Pittet le 3 December 2021

In a ruling dated 6 August 2021 (4A_659/2020), the Federal Court specified the cases in which a bank may invoke international sanctions not recognised in Switzerland to refuse to execute a client's instruction.

On 6 August 2013, a Panamanian company opened a bank account with a Swiss bank. At the end of the company's chain of ownership is Mr Viktor Vekselberg, who indirectly controls the company. Furthermore, the company indicates that Mr Viktor Vekselberg is the beneficial owner of the account. During the relationship, the bank granted the company a loan of USD 160 million secured by securities worth approximately USD 465 million.

In 2014, the United States enacted sanctions against Russia that provide for the freezing of assets of certain designated Russian persons (Specially Designated Nationals and Blocked Persons or 'SDNs'). The sanctions target assets of which the SDNs are owners or holders of an interest in property. These sanctions also include so-called 'secondary' sanctions against non-US financial institutions that intentionally carry out 'significant transactions' for an SDN. In the event of a breach of sanctions, financial institutions are exposed to fines and the possibility of being excluded from US financial markets. On 6 April 2018, the Office of Foreign Assets Control published a list of SDNs on which Mr Viktor Vekselberg appears, but not the company.

Less than three weeks later, the company asked the bank to sell some of its 'A' securities (denominated in USD) to repay its loan. The bank refused to carry out this transaction, arguing that the sanctions imposed by the United States prohibited it from carrying out transactions in USD with the company. The bank then informs the company that the loan (which has been transformed into a (negative) current account balance after reaching maturity) is no longer covered by pledged assets (margin call) and indicates that 'B' securities (not denominated in USD) will be liquidated in order to repay the bank's claim.

The company then brought a legal action before the *Handelsgericht* of the canton of Zurich, asking the court to order the bank (i) to sell the USD-denominated 'A' securities, (ii) to repay the loan using the proceeds of this realisation and (iii) to reimburse the company for interest (withdrawn by the bank) amounting to approximately USD 700,000.

The Federal Court is primarily considering two questions, namely : (i) are the company's assets subject to US sanctions, as the company is not itself a SDN ? and, if so, (ii) does the bank have the option of invoking US sanctions, as these have not been recognised by Switzerland ?

With regard to the first question, the Federal Supreme Court considers that the company's assets in the bank effectively represent an interest in property of Mr Viktor Vekselberg because (i) the latter was designated as the beneficial owner of the account and (ii) according to the legal structure of the group, he was the ultimate beneficial owner of the company's assets. Furthermore, the disputed transaction must be classified as a 'significant transaction'. Therefore, the company's assets are subject to sanctions and the execution of the transaction could have exposed the bank to secondary sanctions.

Regarding the second question, the Federal Court considers that the bank could invoke the following clause in its general terms and conditions to refuse to execute the transaction :

"the Bank may refuse orders which do not correspond with the regulations or standard practices in place at exchanges or other trading centres".

According to the Federal Court, the bank thus had a contractual right to refuse to execute the transaction, regardless of whether or not the sanctions had been recognised in Switzerland.

In the cantonal decision (the operative part of which was confirmed by the judgment summarised here), the *Commercial Court* considered two other legal grounds for allowing the bank to suspend the execution of the client's instruction :

1. The *Handelsgericht* considers that in a mandate contract, there is no right to the execution of the contract if the principal's instructions place the agent in an unreasonably complicated position (which was the case here in view of the risk of violating US sanctions). Therefore, the bank has a legal (and not contractual) right, based directly on the Code of Obligations, to refuse to execute the transaction.
2. Furthermore, the *Handelsgericht* points out that, in the context of examining the guarantee of irreproachable business conduct (art. 3 (2) (c) BA), FINMA takes into account, in particular, compliance with foreign law. In particular, the *Commercial Court* specifies that, according to the FINMA position paper on risks in cross-border financial activities, the financial intermediary is required to take appropriate measures to minimise and eliminate legal and reputational risks in the context of its cross-border activity. Consequently, the bank has a legal right, this time under public law and more specifically under supervisory law, to refuse to execute the transaction.

These two arguments were not addressed by the Federal Court, which considered that the general terms and conditions were a sufficient basis for the bank to refuse to execute the transaction. This ruling therefore shows the importance of addressing this issue in the contractual relationship with the customer, typically by inserting an *ad hoc* clause in the general terms and conditions.

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