#CAATSA #OFAC

Are banks in Switzerland allowed or even obliged to disregard their clients' instructions if following them would violate U.S. sanctions law?

September 3, 2021
Grégoire Mangeat

Dans un tout nouvel arrêt, le Tribunal fédéral laisse ouverte la question de savoir si une banque a l'obligation, en vertu du droit de la surveillance, d'ignorer les instructions d'un client si leur exécution serait contraire au droit américain des sanctions (en l'espèce, le *Countering America's Adversaries Through Sanctions Act* de 2017). Bref commentaire de cet arrêt, non destiné à la publication au recueil officiel.

In a new ruling, the Swiss Federal Supreme Court has left open whether a bank has an obligation under supervisory law to disregard the instructions of a client if compliance with them would violate U.S. sanctions law (in the present case, the Countering America's Adversaries Through Sanctions Act of 2017). We shall cast some light on this decision with a brief commentary.

In its ruling 4A_659/2020 of August 6, 2021, the Swiss Federal Supreme Court (SFSC) upheld a ruling by the Commercial Court of the Canton of Zurich (CCCZ) according to which Swiss bank Julius Baer has an obligation under supervisory law to refuse orders from its clients if compliance with them would violate U.S. sanctions law (more specifically, the Countering America's Adversaries Through Sanctions Act [CAATSA] of 2017). It must be noted, however, that the SFSC neither endorsed nor rejected the CCCZ's reasoning on this point, but instead provided its own reasoning to conclude that Julius Baer at least had the right to disregard its client's instructions.

The client in question was an offshore company (Company) which had deposited securities worth approximately USD 465 million with Julius Baer and had taken out a loan from the bank in the amount of USD 160 million. The declared beneficial owner of the Company's securities deposited with the bank was Russian billionaire Viktor Vekselberg, who on April 6, 2018, was declared by the U.S. Office of Foreign Assets Control (OFAC) a "Specifically Designated National and Blocked Person" (SDN). This meant that the CAATSA henceforth applied to him.

On April 24, 2018 — one day before the repayment of the loan was due — the Company instructed Julius Baer to sell part of its securities denominated in USD and to keep the proceeds as payback. However, Julius Baer did not comply with the instructions and instead converted the Company's loan into a current account with a negative balance of over USD 160 Mio. Julius Baer motivated this course of action by stating that it was prohibited from conducting transactions in USD in connection with the Company due to the OFAC's sanctions. Shortly thereafter, Julius Baer announced to the Company that it would sell those of its shares which are not denominated in USD unless the Company provided a new security — in the amounts of almost USD 157 Mio — for the loan. The Company subsequently sued Julius Baer, demanding once again the sale of part of its securities as well as, inter alia, the unblocking of its other assets.

On November 16, 2020, the CCCZ dismissed the lawsuit. It essentially reasoned as follows:

1 While the Company is not itself on the OFAC's sanction list, it is subject to the CAATSA because the U.S. sanctions also apply to assets in which a SDN has "interests in property". This condition is interpreted broadly and is met in the present case, as Viktor Vekselberg is the beneficial owner of the assets concerned.

2 If Julius Baer would sell the Company's securities denominated in USD as instructed, it would thereby violate U.S. sanctions law. This could lead to substantial penalties against Julius Baer — fines up to twice as much as the transaction volume and potentially even the exclusion from the U.S. financial market (the latter of which would pose an existential threat to the bank).

3 While U.S. sanctions law is not directly applicable in Switzerland, the Swiss Financial Market Supervisory Authority ("FINMA") examines whether banks in Switzerland provide assurance of proper business conduct ("Gewährsprüfung"). In this examination, compliance with foreign law in international operations is examined as a preliminary question. Therefore, Julius Baer is obliged under supervisory law to refuse to carry out transactions in USD which would violate U.S. sanctions law.

4 Moreover, the Company has no contractual claim to the bank's compliance with its instructions because compliance would unreasonably burden the bank's position.

As already stated, on August 6, 2021, the SFSC upheld the CCCZ's ruling. The SFSC essentially dealt with the Company's challenges as follows:

1 The CCCZ's point of view according to which the securities of the Company kept at Julius Baer are subject to U.S. sanctions law (the CAATSA) is correct.

2 Regarding the challenge that the preliminary examination of foreign law by the CCCZ is impermissible, this challenge need not be examined because the Company has not sufficiently substantiated it.

3 While the CCCZ seems to have failed to properly distinguish primary sanctions from secondary sanctions under the CAATSA, that does not change the result.

3 The Company has argued that Julius Baer would not have to sell the securities, but instead could step into the position of the Company regarding the securities and accept this as payback, which would not violate U.S. sanctions law. This question need not be examined because the Company has clearly asked for the *sale* of its securities in its lawsuit (a demand which cannot changed at this stage).

4 With regard to the challenge that nobody would find out about a potential violation of U.S. sanctions law due to the

anonymity of the transactions at issue and that thus, Julius Baer does not incur a real risk of being sanctioned unless it discloses the beneficial owner of the securities to the Custodians, this challenge must be rejected because what is decisive is whether the transactions are contrary to U.S. sanctions law (regardless of whether the violation would be discovered).

5 Whether the CCCZ is right in its assessment that the potential sanctions against Julius Baer resulting from compliance with the Company's instructions would threaten its existence need not be examined because Julius Baer in any case had a *contractual* right to disregard its client's instructions at hand:

6 According to its general terms and conditions, Julius Baer "may refuse orders which do not correspond with the regulations or standard practices in place at exchanges or other trading centers". This rule must be understood so that "regulations" include U.S. sanctions law.

Thus, while the SFSC upheld the ruling of the CCCZ, it neither confirmed nor rejected the latter's fundamental reasoning. Instead, the SFSC held that in the present case Julius Baer had the right to disregard its client's instructions in view of the CAATSA on the basis of a *contractual clause*.

What can be learned from this SFSC ruling? Primarily, that banks in Switzerland should include in their general terms and conditions a rule according to which they may refuse orders which do not correspond with regulations in force at the exchange or other trading center concerned. This way, they can safely avoid severe sanctions from the U.S. or other jurisdictions in cases of the type at hand.

With that having been said, one has to wonder how the SFSC would have ruled if there was no such contractual clause in the present case. Do banks in Switzerland have, as was the CCCZ's position, a right to disregard their clients' instructions in view of potential severe sanctions in the U.S. *independently of a contractual reservation*, and, what is more, an *obligation* to disregard such instructions under Swiss supervisory law? In the past, the SFSC has held — albeit regarding a situation not entirely comparable to the one at hand — that a bank must fulfil its contractual obligations to its client even if doing so would subject the bank to sanctions abroad (4A_168/2015 and 4A_170/2015). While one should probably not read too much into this for the present situation, this earlier jurisprudence at least shows that the SFSC does not take lightly to putting foreign law above contractual obligations under Swiss law.

It is submitted that banks in Switzerland must have the right to refuse their clients' orders if compliance would expose the banks to existential or significant risks here or abroad, even if they have not reserved such a right in their general terms and conditions. Any bank invoking this right must prove that such a threat exists and that there is a certain probability of the threat materializing.

On what legal basis can such a right be based? It seems to us that the best approach lies not in an obligation to follow foreign law under the supervisory law requirement of "proper business conduct" but rather in the law of contracts itself. While banks in Switzerland must certainly assess the risks of their actions abroad and act accordingly, the approach of the CCCZ regarding supervisory law leads to an application of foreign law in Switzerland through the back door which goes too far. Indeed, if foreign sanctions laws are to be binding in Switzerland, this must be achieved by ways of compulsory measures based on the Swiss Embargo Act (CC 946.231). ■

Grégoire Mangeat is one of the founders of MANGEAT and Former Chairman of the Geneva Bar Association (2016 – 2018). He is recommended by Legal 500 and a ranked lawyer by Chambers and Partners.

I am very grateful to Andrés Payer, legal intern at MANGEAT, for excellent research assistance and for helpful comments.