THE EFFECT OF ECONOMIC COERCION ON PRIVATE RELATIONSHIPS

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In discussing the effect of economic coercion on private relationships it is useful to distinguish at the outset between two types of coercitive measures : the vesting of property on the one hand and the interference with contractual relationships on the other hand.

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A typical example of vesting of property is the blocking of Iranian assets by President Carter's Executive Order of 14th November 1979. This is a measure that can be compared with the 1940 Freezing Order of German assets (1) and with the vesting of enemy property in wartime.

With all measures of this type it is a well established rule that their effect is restricted to the territory of the State from which they emanate (2). The problem is however to decide where intangibles, such as debts or securities, are located. An agreement of 5 December 1947 on intercustodial conflicts concerning German enemy assets (3) is an indication of the difficulties encountered in this respect.

The 1979 Executive Order blocked deposits in U.S. dollars made by Iranian public entities with banks, whereever located, organized under the laws of the U.S. or controlled by U.S. nationals or residents (4).

With respect to Iranian dollar deposits in American-owned or controlled banks located outside the United States two opposite views were expressed.

According to Gianviti (5) the dollar deposit must be considered to be located in the books of the branch where it is kept and the blocking measure, to be compared with a garnishment by creditors, must also be localized

(1) Cfr. GIANVITI, *Rev. crit. d.i.p.*, 1980, p. 291.
(2) SEIDL-HOHENVELDERN, *Internationales Konfiskations- und Enteignungsrecht*, p. 8.
(3) See MAURER & SIMSARIAN, *A.J.I.L.*, 1948, p. 158.
(4) See CARREAU, in *Parker School — International Contracts*, p. 175.
(5) *Rev. crit. d.i.p.*, 1980, pp. 298-299.

there. Thus, under those two aspects, the American blocking order can not have an effect on the dollar deposits held with banks or bank branches located in France since such effect would not have the necessary territorial basis.

An entirely different view was expressed by Carreau (6). According to Carreau the currency in which a bank deposit is expressed is the decisive factor. The country whose currency has been used has *in rem* jurisdiction over bank deposits expressed in that currency wherever the bank, with which the currency has been deposited, may be located.

Thus the heart of the matter is the nature of the Euro-dollar, this is a dollar account held on the money market outside the United States. Is this an ordinary money debt, payable in the country where the debtor is located, or is it an account entitling to a credit in the country whose currency has been used? The problem has been discussed, and solved in the latter sense, by Dach (7) and by Mann (8).

In the decision on the summary action (référé) brought against the City Bank in Paris by the Bank Markezi Iran the President of the *tribunal de grande instance de Paris* (M^me^ Rozes) recognized that there was a serious problem requiring full discussion in ordinary proceedings (9).

The vesting of claims will entail the need to decide whether the debtor of the vested claim has thereby been discharged or whether on the contrary the creditor can seek satisfaction of his claim on the debtor's other assets. There have been judicial decisions on this problem after the vesting in Germany by the national-socialist government of Jewish claims against German branches of Swiss insurance companies. Both the German and the Swiss Courts denied the claim of the policyholders or their heirs (10), thus putting on the creditor the burden of the risk of confiscation. The German courts also had had to decide about the claim, confiscated by the French authorities as enemy property, of a depositor with the Alsatian branch of a German bank ; in that case the claim against the head office of the bank in Germany was upheld (11), thus putting the risk of confiscation on the debtor. This has also been the practice of the French Courts, both with respect to an Egyptian confiscation of the local branch of a French insurance company (12) and, more recently, with respect to the nationalization of French businesses in Algeria (13).

(6) *Parker School, International Contracts*, pp. 172-177.
(7) *A.J.I.L.*, 1964, p. 38.
(8) *The Legal Aspect of Money*, 4th ed., pp. 193-195.
(9) Trib. Paris 21 décembre 1979, *Gazette du Palais*, 1980, Jurispr., p. 154.
(10) In Germany : BGH, 11 February 1953, *B.G.H.Z.*, 9, 34 ; in Switzerland : Trib. féd. 26 March 1953, *A.T.F.* 79 II 193.
(11) RG. 22 September 1930, *R.G.Z.* 130, 23.
(12) Cass. 23 October 1963, *J.C.P.*, 1963, II, 13434.
(13) Cass. 23 April 1969, *Rev. crit. d.i.p.*, 1969, p. 717.

In the case of the Iranian assets, the arrangements arrived at in Algiers (14) had as a result to reserve the non-released part of the assets for the claims of U.S. nationals, other creditors of Iran having to look at the assets outside the U.S. blocking.

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The second type of measure to be discussed is the interference with contractual relationships caused by export restrictions (e.g. the Arab oil embargo, the U.S. Export Controls) or import restrictions (e.g. the sanctions against Argentine).

These measures give rise to two types of legal problems. Can the non-performance of for instance a seller be excused on the basis of the performance being prohibited by an export or import restriction? Can the binding force of a contract, such as a sales or transport contract, be denied on the basis that the contractual duty is in violation of an export or import restriction?

The first problem, that of the impossibility of performance, usually arises in connection with contracts that were entered into before the restrictions went into effect. The second problem, that of the enforceability of the contract, will be restricted to contracts entered into when the restrictions were already in effect.

For both these problems there are in existence precedents that came into being in connection with wartime restrictions (of the type of the British Trading with the Enemy Act), exchange controls, smuggling contracts. It will be useful to refer briefly to these precedents before embarking on a closer discussion of the problems.

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The oldest precedents are concerned with smuggling. In the 18th century Pothier (15) criticized a decision of 30 June 1759 of the *Parlement d'Aix* that had upheld the validity of a smuggling contract. Batiffol (16) described the French case-law of the present century as being more inclined to consider such contracts as immoral. This has always been the position of the German Courts (17) and of the British Courts as evidenced in *Foster v. Driscoll* [1929] 1 *K.B.* 470 (in connection with the American « Prohibition ») and in *Regazzoni v. Sethia* [1958] *A.C.* 301 (in connection with an Indian prohibition of exports to South Africa).

(14) *I.L.M.*, 1981, pp. 223-240.
(15) *Contrat d'assurances* n° 58.
(16) *Les conflits de lois en matière de contrats*, pp. 359-361.
(17) BATIFFOL, pp. 358-359.

In all these cases the decision as to the validity and performance of the contract was taken on the basis of the law governing the contract and not the foreign law that was violated. Since the foreign law was not the law governing the contract, it was not applicable as law but was merely a fact to be taken into account in assessing the morality of the conduct of the parties. This is the traditional view, as expressed in 1938 by Batiffol (18).

With respect to a supervening foreign prohibition of performance, the question whether the debtor may rely thereon as an excuse for non-performance is also, according to the traditional view, to be answered on the basis of the law governing the contract. This is the teaching of Batiffol (19) and of Kahn-Freund (20).

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Since the Second World War these traditional views are no longer unquestioned. Doctrinal writings originating in Germany (21) have proposed the view that foreign laws that prohibit performance have to be applied in all cases to which they claim applicability.

The recognition of an excuse for non-performance on the basis of a prohibition by a law that is not the *lex contractus* has found a partial acceptance which must now be described.

In England it has been held since 1920, on the basis of *Ralli Bros. v. Compania Naviera Sota y Aznar* [1920] 1 *K.B.* 614, that « a contract ... is ... invalid in so far as the performance of it is unlawful by the law of the country where the contract is to be performed » (22). It is however controversial whether this is a rule of conflict of laws, applying whatever be the law of the contract, or a rule of the law of contracts, applying only when English law is the *lex contractus* (23).

In the matter of exchange restrictions (that give rise to problems very similar to those arising out of export prohibitions) the Bretton Woods Agreement has introduced, in its Article VIII-2b, the applicability of the law of the country whose currency (meaning financial resources) is involved (24).

(18) *Les conflits de lois en matière de contrats*, p. 355.

(19) *Les conflits de lois en matière de contrats*, pp. 406-408.

(20) DICEY & MORRIS, *The Conflict of Laws*, 8th ed., Rule 134.

(21) WENGLER, *Zeitschrift für die vergleichende Rechtswissenschaft*, 1941, p. 212 ; ZWEIGERT, *Rabels*, 1942, pp. 283-307 ; more recently NEUMAYER, *Rev. crit. d.i.p.*, 1957, pp. 591-593 — on the origin of this theory see MANN, *Beiträge zum Internationalen Privatrecht*, p. 197.

(22) DICEY & MORRIS, *The Conflict of Laws*, 8th ed., Rule 132-Exception.

(23) See the authors cited by KAHN-FREUND, *in* DICEY & MORRIS, *The Conflict of Laws*, 8th ed., pp. 761-762.

(24) On this notion see MANN, *The Legal Aspect of Money*, 4th ed., pp. 391-393.

Recently the Convention signed in Rome on 19 June 1980 between the E.E.C.-countries on the law applicable to contractual obligations has opened for the Courts, in its Article 7-1, the possibility of giving effect to foreign rules, that do not belong to the *lex contractus*, if these rules are intended to apply whatever the law applicable to the contract.

The report by Giuliano and Lagarde states that « the novelty of this provision, and the fear of the uncertainty to which it could give rise, have led some delegations to ask that a reservation may be entered on Article 7-1 ». (25). The German Government has indicated that it will do so and the U.K. Government will probably do likewise.

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The contrast between article 7-1 and the traditional view that only the *lex contractus* is applicable should not be exaggerated.

Article 7-1 does not declare the foreign mandatory laws to be applicable but opens the possibility of giving effect to these laws. Giving effect to a prohibition means that a contract entered into in conscious violation of the prohibition may be held unenforceable and that a breach of performance as a result of the prohibition may be excused on the basis of *force majeure*. But this does not prevent the Court from deciding related problems, such as *culpa in contrahendo* or restitution of payments already made, on the basis of the *lex contractus*. The report by Giuliano and Lagarde explicitly recognizes that « the words 'effect may be given' impose on the Court the extremely delicate task of combining the mandatory provisions with the law normally applicable to the contract in the particular situation in question » (26).

On the other hand the traditional view must recognize that the *lex contractus* can not be applied in the way it would be applied to a purely internal situation, without taking into account the international aspect of the case. Even though the foreign prohibition is not in itself applicable, it is a fact that has to be taken into account when deciding on the validity or the breach of a contractual duty (27).

Thus the problem is always the same, whether it is approached on the basis of article 7-1 of the E.E.C.-Convention or on the basis of the *lex contractus*. It is the problem of deciding whether any foreign prohibition, and if so of what country, will be taken into account in deciding on the enforceability of a contractual obligation.

Whether the stating point be the *lex contractus* or the Courts' discretion under article 7-1 of the E.E.C.-Convention, in both cases it will be necessary

(25) *Official Journal of the European Communities*, 1980, n° C 282, p. 29.
(26) *Official Journal of the European Communities*, 1980, n° C 282, pp. 28-29.
(27) See STEINDORFF, *Sachnormen im internationalen Privatrecht*, p. 237.

to decide whether to take into account a foreign prohibition. The question is not simple and several factors will enter the picture.

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The first factor to be taken in consideration is the view taken about the propriety and ethical importance of the policy underlying the foreign prohibition. The Swiss Federal Tribunal has more than once (28) decided that a contract entered into in conscious violation of foreign exchange control was not immoral ; unlike laws prohibiting drug traffic or white-slave trade, exchange restrictions were held to be mere trade laws without an ethical content that would carry more weight than the respect of the given word (29). By way of contrast the German Courts have declared invalid the contracts aimed at the violation of foreign sanitary laws (30). The English Court of Appeal declared invalid a contract aimed at breaking the American « prohibition » law (31). The distinction between laws prohibiting a *malum in se* and laws prohibiting a *malum quia prohibitum* was advocated by Philonenko (32). Similarly there have been French cases that refused to take into account foreign exchange restrictions when they operated against political refugees (33).

A second factor that can be taken into consideration is the existence of friendly relations or common policies between the *forum* and the foreign law. This factor weighed heavily when the House of Lords declared invalid a contract governed by English law providing for the export of jute bags to South Africa in violation of an Indian law prohibiting the export of goods intended to be taken to South Africa (34). Similarly when the German Supreme Court, in a decision of 21 December 1960 (35) declared invalid a contract entered into in violation of the U.S. prohibition of exports to Communist countries, it did so because that prohibition was held to be in the common interest of all Western countries.

A third factor that can play a role is the closeness of the connection between the content of the contract and the intention to violate a foreign prohibition. In the days of the American alcohol prohibition the French *Cour de Cassation* refused to declare the invalidity of a contract of insurance

(28) 28 February 1950, *B.G.E.*, 76 II 33 ; 30 March 1954, *B.G.E.* 10 II 49.

(29) See MANN, *The Legal Aspect of Money*, 4th ed., pp. 410-411, note 51.

(30) See, by way of example, RG. 5 November 1898, *R.G.Z.* 42, 295 ; RG. 2 December 1903, *R.G.Z.* 56, 179.

(31) *Foster v. Driscoll* [1929] 1 *K.B.* 470.

(32) *Clunet*, 1930, pp. 443-445.

(33) Colmar 24 June 1932, *S.*, 1934 II 73 ; Colmar 16 February 1937, *Rev. crit. d.i.p.*, 1937, p. 685.

(34) *Regazzoni v. Sethia* [1958] *A.C.* 301 ; see on this case MANN, *Modern Law Review*, 1958, p. 130.

(36) *B.G.H.Z.* 34, 169.

covering the sea transport of alcohol up to the limits of the U.S. territorial waters (36). There must be a difference of treatment between the case where the intent to violate the foreign prohibition is common to both parties and the case where only one of the parties has that intention. In the first case the nullity of the contract is not doubted. In the second case it is controversial whether the mere knowledge thereof by the other party entails the nullity or whether it is necessary to show that the other party participated in the unlawful profit (37).

If the contract is declared invalid, the consequences thereof, and in particular the question whether the rule *In pari causa turpitudinis cessat repetitio* applies, can only be governed by the *lex contractus*.

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The problems arising in connection with the possibility of relying on a foreign prohibition to excuse non-performance are of a similar nature.

The prohibition, being imposed by a law that is neither the law governing the contract nor the law of the forum, can not in itself excuse non-performance. It can do so only if it is decided, on the basis of the *lex contractus* or of the Court's discretion under article 7-1 of the E.E.C.-Convention, to take it into account. Here again several factors will enter into the picture.

The first point to be stressed is that a foreign prohibition can not be taken into account when it purports to have a scope of application not permitted by international law.

A conspicuous example is to be found in the amendments of 22 June 1982 to the U.S. Export Administration Act (38) whereby the United States purported to apply the prohibition of exportation to the Soviet Union of certain technology, for use in the Siberian gas pipeline, not only to United States companies but also to foreign companies controlled by United States concerns or using technology originating in the United States. In an *Aide-mémoire* of 14 March 1983 the European Community objected, on grounds of international law, to the application of these regulations to companies incorporated within the Community (39).

The problem was submitted to the President of the *Arrondissementsrechtbank* in The Hague when the Dutch company Sensor tried to rely

(36) Cass. req. 28 March 1928, *Sirey*, 1928 I 305 ; see BATIFFOL, *Les conflits de lois en matière de contrats*, p. 419.

(37) See on this problem DE PAGE, *Traité élémentaire de droit civil belge*, I, 3e éd., n° 94 ; PLANIOL & RIPERT, *Traité pratique de droit civil français*, VI, p. 383 ; R. R. NEUMANN, *Devisennotrecht und internationales Privatrecht*, p. 138 ; Court of appeal Brussels 10 July 1957, *J.T.*, 1958, p. 21.

(38) See the text *in I.L.M.*, 1982, pp. 853 and 1115.

(39) See the text of the Aide-mémoire *in* A. V. LOWE, *Extraterritorial Jurisdiction*, p. 215 and *in I.L.M.*, 1982, p. 891.

on the U.S. prohibition in order to refuse performance of a sale of technical material to the French *Compagnie européenne des Pétroles*. At the request of the French purchaser the Court in The Hague, in a judgment of 17 September 1982, ordered the Dutch seller to perform under penalty of 10.000 guilders per day of delay (40). The main reason supporting the decision was that the U.S. prohibition, having an extra-territorial effect in violation of international law, was not to be taken into account as an exonerating circumstance (41).

The factor of the relations existing, on the international level, between the *forum* and the foreign country whose prohibitory legislation is at stake can not be overlooked. The Swiss Federal Tribunal relied, among other grounds, on the rules of neutrality in order to refuse to take into account a French wartime decree prohibiting trade with German or Austrian-Hungarian subjects (42). Similarly the Dutch *Hoge Raad* refused to take into account the British wartime Trading with the enemy act without, however, explicitly mentioning neutrality as one of the grounds of decision (43).

In contrast to these decisions the German *Reichsgericht*, in a decision that has become famous as a striking and commendable, yet debatable, example of impartiality in the highest German tradition, has in wartime allowed a British seller to rely on the Trading with the enemy act to excuse non performance toward a German purchaser (44).

This German decision shows that there are nuances in the judicial application of the notion of impossibility of performance which is common to all civil law systems as an exonerating circumstance. Whereas the French notion of impossibility, as one of the constituent elements of « *force majeure* », is rather strict, the German notion of difficulties that are such that the debtor can not reasonably be expected to perform (*nicht zumutbar*) leaves greater leeway to the Courts.

In that connection it should also be mentioned that several writers have expressed the opinion that the rule *Genera non pereunt* should be abandoned in international situations complicated by a prohibition emanating from the country where performance was contemplated (45). There is no indication that Courts have explicitly accepted the idea, but the 1918 *Reichsgericht* decision could be explained in that way.

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(40) See a French translation of the judgment *in Rev. crit. d.i.p.*, 1983, p. 473.

(41) For comments on this judgment see Th. M. DE BOER & R. KOTTING, *Nederlands Juristenblad*, 1982, p. 1177 ; B. AUDIT, *Rev. crit. d.i.p.*, 1983, p. 401.

(42) BG. 17 April 1916, *B.G.E.* 42 II 179.

(43) H.R. 2 November 1917, *Nederl. Jurispr.*, 1917, p. 1136.

(44) RG. 28 June 1918, *R.G.Z.*, 1918, p. 182.

(45) ZWEIGERT, *RabelsZ*, 1942, p. 303 ; VISCHER, *Internationales Vertragsrecht*, p. 207 ; Heini, *Berichte der Deutschen Gesellschaft für Völkerrecht*, 22, p. 47.

A distinction can be made between two methods of approaching the problem of impossibility of performance (46). One method inquires into the international admissibility of declaring the foreign prohibition applicable to the facts in issue ; if the answer is negative, the contract will be enforced.

This method finds its source in public international law ; it can be called jurisdictional. The Hague decision of 1982 is a good example. Another methods looks only at the situation of the debtor. Without inquiring about the international propriety of the foreign prohibition, it merely looks into the question whether the factual effects of the prohibition are such that performance can not reasonably be required. This method finds its source in the law of contract ; it can be called substantive. The *Reichsgericht* decision of 1918 is a good example.

The two methods will often coincide in their results but not always. There was coincidence in the 1982 Hague case since the Dutch firm could be compelled by the Dutch judicial authorities to perform despite the American embargo ! There was also coincidence in the well-known *Fruehauf case* where the French Courts took steps to safeguard the performance of a contract between two French firms despite foreign attempts at interference (47).

There will be no coincidence in the cases, admittedly rather rare, where an internationally inacceptable foreign prohibition will have the effect of putting the debtor in a factually unbearable situation. On the other hand there will be no coincidence either in the cases where, despite a foreign prohibition that could internationally be considered as acceptable, the debtor will nevertheless not be placed in a position where it would be inreasonable to compel performance.

It is submitted that the debtor should be excused from breach of performance only when the two conditions are simultaneously present. He factually finds himself in a situation that can reasonably be equated to impossibility of performance and this situation is the result of a foreign interference that is not unacceptable under international rules of jurisdiction. Admittedly this may, in certain situations, be harsh on the debtor. But upholding the jurisdictional approach is necessary in order to prevent a situation where the export policy of our countries is dictated from abroad, as the U.S. purported to do in the Siberian pipeline case.

(46) Comp. De Boer & Kotting, *N.J.B.*, 1982, p. 1177 ; Audit, *Rev. crit. d.i.p.*, 1983, p. 16.
(47) Paris, 22 May 1965, *D.*, 1968, p. 147.