

COMMISSION OF THE EUROPEAN COMMUNITIES

SEC(91) 1363 final

Brussels, 12 July 1991

Proposal for a
COUNCIL REGULATION (EEC)
prohibiting to honour Iraqi claims with regard to contracts and
transactions affected by the United Nations Security Council
resolution 661 (1990) and related resolutions

(presented by the Commission)

EXPLANATORY MEMORANDUM

I. General Considerations

1. After the invasion of Kuwait by Iraq, the United Nations Security Council adopted resolution 661 (1990) and related resolutions, imposing inter alia an economic and financial embargo on Iraq. The embargo forced non-Iraqi operators to discontinue commercial or economic relations with Iraq and brought to a halt the performance of contracts already concluded.

On the 3 April 1991 the United Nations Security Council adopted resolution 687 (1991). This so-called "cease-fire" resolution foresees inter alia the lifting of the embargo, after the fulfillment of the necessary conditions by Iraq.

Paragraph 29 of this resolution reads:

(The Security Council) "Decides that all States, including Iraq, shall take the necessary measures to insure that no claim shall lie at the instance of the Government of Iraq, or of any person or body in Iraq, or of any person claiming through or for the benefit of any such person or body, in connection with any contract or other transaction where its performance was affected by reason of the measures taken by the Security Council in resolution 661 (1990) and related resolutions;"

2. Paragraph 29 thus provides for protection of economic operators against unjustified claims by Iraqi individuals, companies or organizations. In doing so, it prevents Iraq from obtaining compensation retroactively for the negative effects of the embargo.

Regarding exposure to claims from Iraq, the banking sector as well as European International contractors, have pointed to the fact that a lifting of the embargo could give rise to an avalanche of requests for payment of performance bonds, guarantees, stand-by credits or similar instruments under existing contracts and transactions for reasons of non-performance. The estimated amount of money involved exceeds 500 million ECU. Already now exposure of such a dimension seriously reduces the financial room for manoeuvre of contractors. If the corresponding claims would effectively have to be honoured, the consequences on companies would be dramatic.

As regards the position of Iraq, obtaining payment would mean an important financial advantage which would clearly be in contradiction with the very objective pursued by the embargo.

3. Under these conditions, § 29 gives a clear signal that both consequences of admitting claims (i.e. losses for non-Iraqi operators and compensation to Iraq) are unacceptable to the International community. It is important that in implementing the UN decision, the effect of this signal is not weakened. This is all the more true, as there is, for the time being, no indication that the embargo could effectively be lifted, given the apparent reluctance of Iraq to comply fully with all conditions set out in Resolution 687.

It also seems clear that the practical result intended by § 29 can only be achieved if the principles contained therein are implemented in a uniform way. In a great number of cases, contracts or transactions concerned involve companies and banks in different countries. Different national approaches as regards the modalities of protection granted are therefore bound to weaken the efficiency of such protection altogether. Furthermore, such differences would give rise to distortion of competition between operators in different countries, thus affecting common commercial policy. This calls for implementation, at Community level, by a Community instrument. It also requires close consultation between the Community and third countries, in particular OECD members.

II. Specific considerations

The measures proposed herewith in order to implement § 29 of UNSC Resolution 687 (1991) are based on the following specific considerations:

1) Non-enforceability of claims or prohibition to pay

§ 29 can be interpreted either as making claims by Iraq non-enforceable, or as establishing a prohibition to honour such claims. The practical consequences of each interpretation are different. A system of NON-ENFORCEABILITY would protect banks and exporters against claims mentioned in paragraph 29 of UNSC Resolution 687, by making it impossible for any Iraqi party to obtain a judgment in its favor unless it could prove that the contract or transaction was not affected by the embargo.

However, such a system would allow claims being settled by agreement between the parties concerned. This would considerably weaken the protection granted, as it would expose non-Iraqi operators, in particular contractors, to pressure which might be exerted by the Iraqi side. It would also create uncertainty as to whether the contracts concerned would still have to be treated as valid obligations. Finally, this system would not permit the achievement of the other objective of § 29, i.e. the prevention of retroactive compensation in favour of Iraq.

Therefore, the Commission proposes a system of PROHIBITION TO HONOUR CLAIMS, which would allow to meet both the objective of preventing such retroactive compensation as well as the objective of an effective protection of non-Iraqi parties, and would establish clarity as regards the treatment of the contractual obligations concerned.

Furthermore, Member States should take all steps required in order to ensure effectiveness of the prohibition, including the establishment of sanctions in case of non-respect.

2) Burden of proof

The protection granted to non-Iraqi parties would be imperfect if contractors or banks, when defending themselves against Iraqi claims, would have to prove that the conditions of § 29 are met. Therefore, the burden of proof should be reversed. Consequently, contracts or transactions with regard to which claims are made are regarded as having been affected by the embargo, unless the claimant provides proof to the contrary.

3) Possible exceptions

Although the Commission recognizes that an unrestricted application might in some cases lead to hardship, it appears impossible to define in a general way, situations in which the performance of a contract has not been affected by the embargo. The Commission is therefore of the opinion that exceptions from the general rule should be limited to the case where payment has been ordered by a court or a comparable authority provided the legislation applied provides for an effective implementation of the principles contained in § 29 of UNSC Resolution 687.

4) Relationship between contractors and banks

Finally, the issue of INDEMNITIES - i.e. the right of a party which has honoured a claim, to obtain the repayment by another party - needs to be addressed. Indemnities have normally to be paid by exporters to banks when the latter have paid out a guarantee. Indemnisation is also granted by export-credit insurers to exporters, when the conditions of the credit-insurance policy are fulfilled.

As a principle, no right to indemnisation can be recognized where the claim should not have been honoured. The question arises, however, if parties should be allowed to obtain indemnity for payments that they were forced to make, e.g. through legal execution, although the Iraqi party was not entitled to the payment under § 29 of UNSC Resolution 687 (1991).

While the Commission recognizes that in such cases it could seem inadequate not to open the possibility of recourse, this possibility is not included in the present proposal. It would considerably weaken the position of exporters whereas banks appear to be in a relatively stronger position vis-à-vis Iraqi claimants; in fact, so far no cases of legal execution or similar measures against banks seem to have occurred. The question may, however, have to be reconsidered in the light of further experience.

COUNCIL REGULATION (EEC) No/91
of 1991

prohibiting to honour Iraqi claims with regard to contracts and transactions affected by the United Nations Security Council resolution 661 (1990) and related resolutions.

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Whereas, under Regulation (EEC) N°2340/90⁽¹⁾ and (EEC) N°3155/90⁽²⁾, both as last amended by Regulation (EEC) N°1194/91⁽³⁾, the Community has taken measures to prevent trade by the Community as regards Iraq;

Whereas as a consequence of the embargo against Iraq economic operators in the Community and third countries are exposed to the risk of claims by the Iraqi side;

Whereas it is necessary to protect operators against such claims and to prevent Iraq from obtaining compensation for negative effects of the embargo;

Whereas the Security Council of the United Nations adopted resolution 687 (1991) of 3 April 1991 which, in its paragraph 29, deals with claims by Iraq in relation with contracts and transactions affected by measures taken by the Security Council in resolution 661 (1990) and related resolutions;

Whereas the Community and its Member States have agreed to establish a Community Instrument in order to ensure an uniform implementation, throughout the Community, of paragraph 29 of the Security Council resolution 687 (1991);

(1) OJ N° L 213, 9.8.1990, p.1

(2) OJ N° L 304, 1.11.1990, p.1

(3) OJ N° L 115, 8.5.1991, p.37

Whereas such an uniform implementation is necessary to achieve the aims of the Treaty establishing the European Economic Community and whereas no other powers are available in the Treaty than in article 235;

Having regard to the Treaty establishing the European Economic Community, and in particular Article 235 thereof;

Having regard to the proposal from the Commission;

Having regard to the opinion of the European Parliament;

HAS ADOPTED THIS REGULATION:

ARTICLE 1

For the purpose of the present Regulation

1) "contract" or "transaction" means:

- any contract or transaction, including guarantees, bonds (e.g. performance bonds, bid bonds), stand-by credits, subcontracts.

2) "claim" means any demand or action on the side of a party to a contract or a transaction for the fulfillment of an obligation resulting from or connected with such a contract or transaction by another party, such as:

- a demand to pay a bond or guarantee;
- a demand to continue or to start activities foreseen under a contract or transaction;
- a demand to provide indemnity for a payment made under a contract or a transaction;
- a demand for an injunction from a court, for an arbitral award or for the execution of such injunction or award.

- 3) "measures taken by the Security Council in Resolution 661 (1990) and related resolutions" means measures of the United Nations Security Council, and measures introduced by the European Communities, any country or international organization in pursuance of the relevant decisions of the Security Council, or any other action authorized by the Security Council in respect of the invasion of Kuwait by Iraq, such as military activities in connection with the liberation of Kuwait;
- 4) "person or body in Iraq" includes any person or body resident in Iraq, any body incorporated or constituted under law of Iraq and any body controlled by any persons or bodies resident in Iraq or bodies incorporated or constituted under the law of Iraq;

ARTICLE 2

As from 3 April 1991, it shall be prohibited to honour any claim made by the Government of Iraq, or any person or body in Iraq, or any person claiming through or for the benefit of any such person or body, directly or indirectly, in connection with any contract or other transaction where its performance was affected by reason of the measures taken by the Security Council in Resolution 661 (1990) and related resolutions.

ARTICLE 3

Without prejudice to existing prohibitions with regard to commercial and financial relations with Iraq, Article 2 does not apply, when

- a) a claimant has obtained a judgment from a court or an award or an equivalent decision that the performance of the contract or transaction was not affected by measures mentioned in Article 2

and

- b) the judgment, award or equivalent decision was obtained within the jurisdiction of a country that had faithfully implemented the measures taken by the Security Council in resolution 661 (1990) and related resolutions, and in particular paragraph 29 of resolution 687 (1991).

ARTICLE 4

The onus of proving that the performance of the contract or transaction was not affected by measures mentioned in Article 2, shall be on the person making a claim.

ARTICLE 5

The Member States will take the necessary measures to ensure the effectiveness of the disposition of Article 2, 3 and 4.

ARTICLE 6

This Regulation shall enter into force on the day of its publication in the Official Journal of the European Communities.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,1991

For the Council