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CLIENT ALERT

EU Blocking Statute May Be Given Teeth Against U.S. Sanctions Under Advocate General Recommendation

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On May 12, 2021, Advocate General Hogan (the "AG") of the Court of Justice of the European Union (the "Court") issued his opinion in *Bank Melli Iran, Aktiengesellschaft nach iranischem Recht v Telekom Deutschland GmbH*,[1] which concerned the interpretation of Council Regulation (EC) No 2271/96 (as amended), also known as the EU Blocking Statute. Whilst the opinions of AGs are not legally binding on the Court's decisions, they are influential and followed in many cases. The next step is for the Court to consider the parties' submissions alongside the AG's Opinion and then deliver its own judgement.

The practical effects of the AG's opinion are threefold:

1. the general prohibition in Article 5 of the EU Blocking Statute, prohibiting EU persons from complying with listed U.S. sanctions, prohibits an EU operator from complying with listed secondary sanctions imposed by a foreign jurisdiction without first having been compelled to do so by an administrative or judicial agency of the United States;

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[1] Case C-124/20.

2. an EU entity or person seeking to terminate an otherwise valid contract with an Iranian entity subject to U.S. sanctions must demonstrate to the satisfaction of its national court that it did not do so for the purposes of complying with those sanctions; and

3. where an EU entity or person fails to comply with the EU Blocking Statute with respect to U.S. secondary sanctions legislation, the national court of the sanctioned party is required to order the EU party to maintain the contractual relationship.

If EU courts adopt the AG's reasoning, they could put EU companies between a rock and a hard place, forced to choose between a contractual obligation involving Iran or Cuba and the threat of sanctions from the United States. In this client alert, we consider the implications of the AG's opinion on the application of the EU Blocking Statute.

Background

U.S. sanctions targeting Iran

U.S. sanctions are implemented primarily by the U.S. Department of the Treasury's Office of Foreign Assets Control ("OFAC"). U.S. sanctions can generally be divided into two categories: so-called "primary" sanctions and "secondary" sanctions. Primary sanctions prohibit U.S. persons[2] from engaging in activity with a sanctioned person. In the case of Iran and Cuba, those restrictions generally extend also to any foreign entity owned or controlled by a U.S. person. A violation of U.S. primary sanctions can result in civil or criminal enforcement in the United States.

Secondary sanctions authorize OFAC or the U.S. State Department to threaten sanctions on a non-U.S. person for specified activity. These sanctions are intended to discourage non-U.S. persons from engaging in certain transactions that are contrary to U.S. foreign policy and national security goals. Secondary sanctions can be imposed on a non-U.S. person even if the transaction has no U.S. nexus (and is thus not subject to primary sanctions).

This client alert addresses the implications of the AG's opinion for companies terminating relationships with Iranian entities specifically to avoid the threat of secondary sanctions by the United States.

The EU Blocking Statute

The EU Blocking Statute was adopted by the EU in 1996 in response to comprehensive sanctions imposed by the United States on Cuba and Iran. The stated purpose of the EU Blocking Statute is to protect EU operators[3] engaged in lawful

[2] The term "U.S. person" is generally defined in U.S. sanctions regulations as a U.S. citizen, permanent resident alien, entity organized under the laws of the United States or any jurisdiction within the United States (including foreign branches), or any person in the United States. *See*, *e.g.*,31 C.F.R. § 560.314.

[3] Within the meaning of Article 11 of the EU Blocking Statute.

international trade from the effects of extraterritorial legislation, in particular, U.S. sanctions. It achieves this by (1) nullifying the effect in the EU of any ruling of a foreign court based on the laws in the Annex to the EU Blocking Statute; and (2) allowing EU operators to recover in court any damages caused by the extraterritorial application of those same laws.

The key provision of the EU Blocking Statute at issue in this case was that of the first paragraph of Article 5:

No person referred to in Article 11 shall comply, whether directly or through a subsidiary or other intermediary person, actively or by deliberate omission, with any requirement or prohibition, including requests of foreign courts, based on or resulting, directly or indirectly, from the laws specified in the Annex or from actions based thereon or resulting therefrom.

It should be noted that the EU Blocking Statute currently only applies to the following U.S. sanctions laws and regulations targeting Cuba and Iran:

1. Cuban Democracy Act of 1992
2. Cuban Liberty and Democratic Solidarity Act of 1996
3. Iran Sanctions Act of 1996
4. Iran Freedom and Counter-Proliferation Act of 2012
5. National Defense Authorization Act for Fiscal Year 2012
6. Iranian Transactions and Sanctions Regulations, 31 C.F.R. Part 560
7. The Cuban Assets Control Regulations, 31 C.F.R. Part 515

Facts of the case

The case concerned the Iranian bank, Bank Melli Iran, which had a branch in Hamburg, Germany, and had entered into a number of telecommunication services contracts with Telekom Deutschsland GmbH, a subsidiary of Deutsche Telekom. Following the United States' withdrawal from the Iran nuclear deal, the Joint Comprehensive Plan of Action ("JCPOA"), Bank Melli Iran was placed on OFAC's List of Specially Designated Nationals and Blocked Persons.[4] Shortly afterwards, Telekom Deutschland GmbH served notice to terminate all of its contracts with Bank Melli Iran, giving no reason for doing so. Bank Melli Iran initiated proceedings against Telekom Deutschland, claiming infringement of the EU Blocking Statute.

[4] Bank Melli Iran had previously been on this list since 2007, before certain U.S. sanctions targeting Iran were lifted following implementation of the JCPOA.

The German court of first instance ruled in Telekom Deutschland's favour in only requiring the firm to perform the contracts for the period of its termination notice. This decision was appealed by Bank Melli Iran, with the appeals court referring the interpretation of the EU Blocking Statute to the court for a preliminary ruling. In line with the rules of procedure for the court, the AG then delivered his Opinion after the close of the hearing.[5] The court will take the AG's Opinion into account before delivering its ruling, so the ultimate ruling of the court could still differ from the AG's conclusions.

Summary of the Advocate General's Opinion

Question 1: Does the first paragraph of Article 5 only apply where the EU operator is instructed or ordered to comply with U.S. sanctions by a U.S. administrative or judicial authority, or is it sufficient that the EU operator is voluntarily complying with such sanctions?

The AG noted that Article 5 forbids compliance with "*any requirement or prohibition…based on or resulting, directly or indirectly*" from one of the laws specified in the Annex.

The wording of the first paragraph of Article 5 as well as the context and objectives of the EU Blocking Statute, the AG concluded, therefore clearly support the interpretation that the prohibition in Article 5 applies even in the event that an EU operator voluntarily complies with the relevant sanctions legislation without first having been compelled by a U.S. administrative or judicial agency to do so.

Question 2: Must the first paragraph of Article 5 be interpreted as overruling a national law under which an EU operator may terminate a contract with an SDN without giving a reason for doing so?

To begin with, Article 5 must be interpreted, stated the AG, as conferring rights upon foreign entities that are sanctioned by the United States, such as Bank Melli Iran, to rely on that provision. The AG noted that if such right was not conferred on foreign entities, Member States could themselves choose not to enforce the EU Blocking Statute, and could allow large economic operators such as Telekom Deutschland to freely comply with U.S. sanctions regimes without any repercussions.

Second, the AG determined that Article 5 must therefore also be interpreted as requiring an EU operator that is seeking to terminate an otherwise valid contract to demonstrate to the satisfaction of its national court that it did not do so by reason of its desire to comply with U.S. sanctions. Otherwise, EU operators could decide to comply with U.S. sanctions and terminate business dealings, and then, by staying silent so that their motives cannot be examined, easily sidestep the policy objectives of the EU Blocking Statute entirely.

[5] Article 82, Rules of Procedure of the Court of Justice.

Questions 3 and 4: Should the first paragraph of Article 5 be interpreted as meaning that ordinary termination is deemed ineffective or can an alternative penalty be imposed? If the former, does this still apply given that: (1) the possibility of an authorised exemption under the second paragraph of Article 5 should be interpreted restrictively; (2) such an injunction may infringe Article 16 (freedom of enterprise) of the Charter of Fundamental Rights of the European Union; and (3) maintaining such business relationship with an SDN would expose the EU operator to considerable economic losses in the U.S. market?

Where an EU entity or person fails to comply with the EU Blocking Statute, the national court with jurisdiction over the case is required to order the EU party to maintain the contractual relationship. It was the opinion of the AG that the prohibition in Article 5 was not contrary to Article 16 of the Charter of the Fundamental Rights of the European Union.

Conclusion

As noted by the AG, the EU Blocking Statute "*is a very blunt instrument*" and being designed to "*sterilise the intrusive extraterritorial effects of U.S. sanctions within the Union…will inevitably bring casualties in its wake.*" Despite this, it was the duty of the Court to give effect to the language of the legislation, and as such, the AG considered it correct for the first paragraph of Article 5 to have such far-reaching effects, even if they may be thought to override ordinary business freedoms in an unusual and intrusive manner.

What next?

EU operators who engage in business with entities linked to Iran or Cuba are well-advised to keep a close eye on the outcome of this case. This is particularly true for operators who have substantial business interests involving the United States. EU operators who export goods or services from the United States to a person subject to U.S. sanctions or who cause a violation by a U.S. person by involving a U.S. person in a transaction with a person subject to U.S. sanctions can be held liable under U.S. primary sanctions and subject to civil or criminal enforcement in the United States. EU operators that engage in certain activity that meets the criteria for U.S. secondary sanctions risk the imposition of sanctions, which could include measures such as potentially being designated as an SDN themselves, with the consequence being that they are excluded from the U.S. financial system and prohibited from dealing with U.S. persons. At the same time, the AG's Opinion, if adopted by the Court, could put companies at risk for civil liability for terminating their contracts with Cuban and Iranian entities.

The EU Blocking Statute has also been enshrined in UK law post-Brexit,[6] with the UK courts holding the power to apply and interpret the EU Blocking Statute accordingly. As a result, UK operators could end up subject to the same restrictions under the EU Blocking Statute as those subject to EU jurisdiction.

[6] Via The Protecting against the Effects of the Extraterritorial Application of Third Country Legislation (Amendment) (EU Exit) Regulations 2020.

It should be noted that the second paragraph of Article 5 does offer EU firms the possibility of requesting an authorised exemption, allowing them to comply with U.S. laws and regulations, to the extent that "*non-compliance would seriously damage their interests or those of the Community.*" However, it would be wise to assume that the issuance of such waivers will be limited in quantity, due to the diminishing effect they will have on the "bite" of the EU Blocking Statute.

There may be, however, one potential further lifeline for EU operators caught between the U.S. and EU regimes. In his opinion, the AG stated that EU operators could be deemed as having a sincere reason to terminate an otherwise valid contract with an Iranian entity subject to U.S. sanctions, by demonstrating that they are actively engaged in a "*coherent and systematic corporate social responsibility policy,*" which requires them to refuse to deal with any companies having links to the Iranian regime, for ethical reasons. EU operators may therefore wish to review their own corporate social responsibility policies now and to consider whether such policies may need to be updated in line with the ethical values of the company.

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