Fried Frank International Trade and Investment *Alert*™

The EU backs the Iran nuclear deal

On 7 August 2018, the European Council implemented a revised blocking statute (the "EU Blocking Statute") in direct response to President Trump's decision to unilaterally withdraw the United States from the Iran sanctions relief program. While aimed at ensuring that EU companies can continue to trade with Iran, it will put companies in an impossible legal position, especially those that are trading in both the U.S. and the EU. Hopefully both the U.S. and the EU regulators will recognize the paradox companies now face and exercise their enforcement discretion tactfully. Yet, it is up to each transatlantic company to decide which regime to follow.

The EU Blocking Statute aims to promote trade between the EU and third countries, and permits the imposition of penalties on European companies who break off their business activities due to ex-EU (sanction) laws.[1] The EU Blocking Statute had previously listed U.S. laws relating to Cuba and Libya, and now also, again, includes U.S. laws relating to Iran.

The revision was chiefly triggered by (1) President Trump's unilateral decision on 8 May 2018 to withdraw the United States from the Joint Comprehensive Plan of Action (the "JCPOA"), signed in 2015 between Iran, on the one hand, and China, France, Russia, the UK, Germany, the U.S. and the EU on the other hand, and by (2) President Trump's issuance on 6 August 2018 of an Executive Order "Reimposing Certain Sanctions with Respect to Iran"[2] reinstating previously lifted nuclear-related sanctions under the JCPOA agreement.

Background

The EU Blocking Statute was initially introduced in 1996 in response to the U.S. extra-territorial sanctions legislation concerning Cuba, Iran and Libya. The EU Blocking Statute prohibits EU companies from complying with the extra-territorial sanctions that exceed those of the EU, but its role also ensures their protection by (1) allowing companies to recover damages arising from sanctions imposed on them and (2) nullifying the effects of such decisions in the EU.

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1 The EU Blocking Statute - Council Regulation of 22 November 1996 protecting against the effects of the extra-territorial application of legislation adopted by a third country - is available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:31996R2271&from=EN, with the updated text available at https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018R1100&qid=1534749372482&from=EN.

2 Executive Order Reimposing Certain Sanctions with Respect to Iran of 6 August 2018, available at: https://www.whitehouse.gov/presidential-actions/executive-order-reimposing-certain-sanctions-respect-iran/.

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Although the EU Blocking Statute has direct legal effect in all EU Member States, each is required to pass national implementing legislation determining the penalties to be imposed in the event of a breach. To date only a handful of countries have implemented a domestic penalty regime (e.g., the UK[3], the Netherlands, Austria, Germany and Sweden).[4] More importantly, the EU Blocking Statue has been the object of only one launched enforcement in 2007 when the Austrian authorities brought an enforcement action against BAWAG - one of Austria's largest banks - for cancelling accounts held by Cuban nationals, due to the U.S. sanctions against Cuba, in order to facilitate its sale to the U.S. investor Cerberus Capital. The investigation against BAWAG was eventually discontinued, the latter having been granted an exemption by the U.S. authorities, and the accounts unduly cancelled reinstated.[5]

This clearly contrasts with the attitude of the U.S. Treasury Department's Office of Foreign Assets Control (the "OFAC"), which has aggressively enforced U.S. sanctions compliance in the past and is likely to continue doing so in this instance. In July 2013, American Express Travel Related Services Company, Inc. ("TRS") settled a potential civil liability by paying US$ 5,226,120 for alleged violations of the Cuban Assets Control Regulations, 31 CFR part 515 (the "CACR"). TRS was accused of having issued, through its foreign branch offices and subsidiaries, 14,487 tickets for travel between Cuba and countries other than the U.S., many of which had adopted blocking statutes prohibiting compliance with the CACR, without being authorized by the OFAC. Interestingly, and although considering the difficult position in which TRS was - having to comply with both the CACR and blocking statutes in place in many jurisdictions in which TRS' foreign branches offices and subsidiaries operated - as a relevant factor, the OFAC nevertheless rejected treating these circumstances as a mitigating factor.[6]

What has now changed?

At first glance, one might be tempted to say very little has changed: The EU "merely" expanded the scope of the listed extra-territorial legislation to re-include Iran to the protective measures in the EU Blocking Statute.

Consequently, the revised EU Blocking Statutes still contains prior uncertainties caused by broad and sometimes vague language. For instance, companies and person under EU jurisdiction shall not "*comply*" with the U.S. extra-territorial sanctions (Art. 5 EU Blocking Statute). What compliance entails remains open for debate. E.g., the Commission has recognized that *"[i]t is not usually possible to establish that [a company's] decision [to not/no longer conduct trade in Iran] is a direct result of the US legislation than a commercial decision."*[7]

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3 Although not confirmed, we would anticipate that the UK will continue to operate some form of a blocking statute also post-Brexit.

4 Financial Markets Law Committee, Working Group on US Sanctions and EU Blocking Regulation, 7 August 2018.

5 European Parliament's Briefing, Updating the Blocking Regulation: The EU's answer to US extraterritorial sanctions, available at: http://www.europarl.europa.eu/RegData/etudes/BRIE/2018/623535/EPRS_BRI(2018)623535_EN.pdf.

6 A summary of the case is available at: https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20130722_american_express_trs.pdf. An example of a similar 2014 case against Carlson Wagonlit is available at: https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20140418_cwt.pdf.

7 Parliamentary questions, 1 April 2015 (E-007804/2014), Answer given by Vice-President Mogherini on behalf of the Commission, at: http://www.europarl.europa.eu/sides/getAllAnswers.do?reference=E-2014-007804&language=EN. See also: Updating the Blocking Regulation, supra note 4.

A note published by the Commission on the Blocking Statute[8] (the "Guidance Note") provides some clarification. It assures that EU operators are free to continue (or cease) operations in Iran or Cuba as long as such decision is "*not forced upon*" them by U.S. extra-territorial sanctions.[9] The Guidance Note helpfully confirms further that *"the simple pursuit of conversations with the U.S. authorities in order for EU operators to ascertain [the] exact extent"* of the U.S. extra-territorial legislation is not regarded as compliance within the meaning of Article 5 of the EU Blocking Statute. Yet, requesting a derogation/exemption from the U.S. authorities from the U.S. extra-territorial legislation - in the Commission's view - amounts to (illegal) compliance with the U.S. regime, unless the EU operator previously requested an authorization from the Commission to apply for such license.[10]

Outside the area of engaging with U.S. authorities, there is little guidance on what would qualify as a (EU illegal) compliance with U.S. extra-territorial sanctions. Conversely, the EU has provided clarification on the criteria to obtain an EU authorization to not fully comply with the EU Blocking Statute: here, the Guidance Note makes clear that the authorization procedure is not aimed at the Commission ratifying business decisions made by EU companies but, on the contrary, is designed to ensure that the derogation is business motivated (rather than legally) and that appropriate evidence is put forward. The applicant must show that non-compliance with the listed extra-territorial legislations would seriously damage its interests or those of the EU. In doing so, EU operators can now also rely on an accompanying Implementing Regulation[11], which sets out criteria to satisfy (and a procedure to follow) to obtain an exemption. In its assessment of whether such serious damage is likely to occur, the Commission will consider, *inter alia*: whether the applicant would face significant losses, the security of supply of strategic goods or services within the EU or a Member State and the impact of any shortage or disruption, whether measures could be reasonably taken by the applicant to avoid or mitigate the damage, and the existence of a substantial connecting link with the country issuing the sanctions.

Finally, the Guidance Note provides some clarification regarding the jurisdictional reach of the EU Blocking Statute for subsidiaries and branches. While an EU subsidiary of a U.S. company has to comply with the EU Blocking Statute, neither (1) an EU branch of a U.S. company nor (2) a U.S. subsidiary of an EU company have to.[12] Also, an EU subsidiary of a U.S. company, as well as a U.S. branch of an EU company, are likely required to comply with the EU Blocking Statute, too.

A time of uncertainties

The climate of tension created by the tit-for-tat between the U.S. and the EU is, first and foremost, detrimental to companies conducting business in Iran, which are now bound to assess the likely political and legal impact, as well as in terms of risk management, of favouring compliance with either of the re-

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8 Guidance Note on the adoption of update of the Blocking Statute, available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:JOC_2018_277_I_0003&from=EN.

9 Guidance Note, supra note 8, Q&A no 5.

10 Guidance Note, supra note 8, Q&A no 23.

11 Commission Implementing Regulation (EU) 2018/1101 of 3 August 2018 laying down the criteria for the application of the second paragraph of Article 5 of Council Regulation (EC) No 2271/96 protecting against the effects of the extra-territorial application of legislation adopted by a third country, and actions based thereon or resulting therefrom, available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018R1101&from=en.

12 Guidance Note, supra note 8, Q&A no 21.

instated U.S. sanctions against Iran or the EU Blocking Statute. Notably, times have changed since the 1990s, when the U.S. and EU first sparred over the enforcement (or blocking) of the U.S. extra-territorial sanctions. Then, in 1998, the U.S. and EU came soon to a mutual agreement that shielded EU operators. While a similar proposal has been put forward by officials from the UK, Germany, and France to President Trump, the U.S. has reportedly rejected the proposal.[13]

The EU Blocking Statute will probably prove helpful to EU operators that have no connections with the United States; conversely, EU operators with *"important economic interests in the US may simply prefer to pull out of Iran*".[14] Further, the EU's political move will put globally active financial institutions providing funds directed to Iran in a difficult position, as underlying financing agreements typically contain warranties, that the obligor is compliant with U.S. sanctions. Obligors can provide such warranties, provided a carve-out is included that they do not violate the EU Blocking Statute. Of interest, the warranties in transactions with a German nexus focus on companies resident in Germany. This will likely continue, as the German anti-boycott provisions are further reaching than the EU Blocking Statute prohibiting any statement in compliance with foreign embargoes, e.g. Saudi Arabia's led embargo of Qatar.

In this context, it also remains to be seen whether the European Investment Bank (the "EIB"), the EU's non-profit long-term investment arm, will actually go ahead with funding projects in Iran (despite obtaining from the European Parliament last July the extension of its mandate, so that Iran becomes eligible for EIB lending). Shortly after the announcement, the EIB President Werner Hoyer declared that Iran is a place *"where [EIB] cannot play an active role"*, considering such implication could put the institution's global operations at risk by jeopardizing its ability to raise sizeable money on U.S. capital markets.[15] With various major European companies now exiting Iran, and the Iranian government threatening to stop complying with its nuclear program, the future of the JCPOA remains uncertain.

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[13] https://www.bloomberg.com/news/articles/2018-07-13/mnuchin-pompeo-said-to-reject-european-bid-for-iran-waivers.

[14] Updating the Blocking Regulation, supra note 4, page 7.

[15] More details available at: https://www.reuters.com/article/us-iran-nuclear-eu/european-investment-bank-casts-doubt-on-eu-plan-to-salvage-nuclear-deal-idUSKBN1K81BD.

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