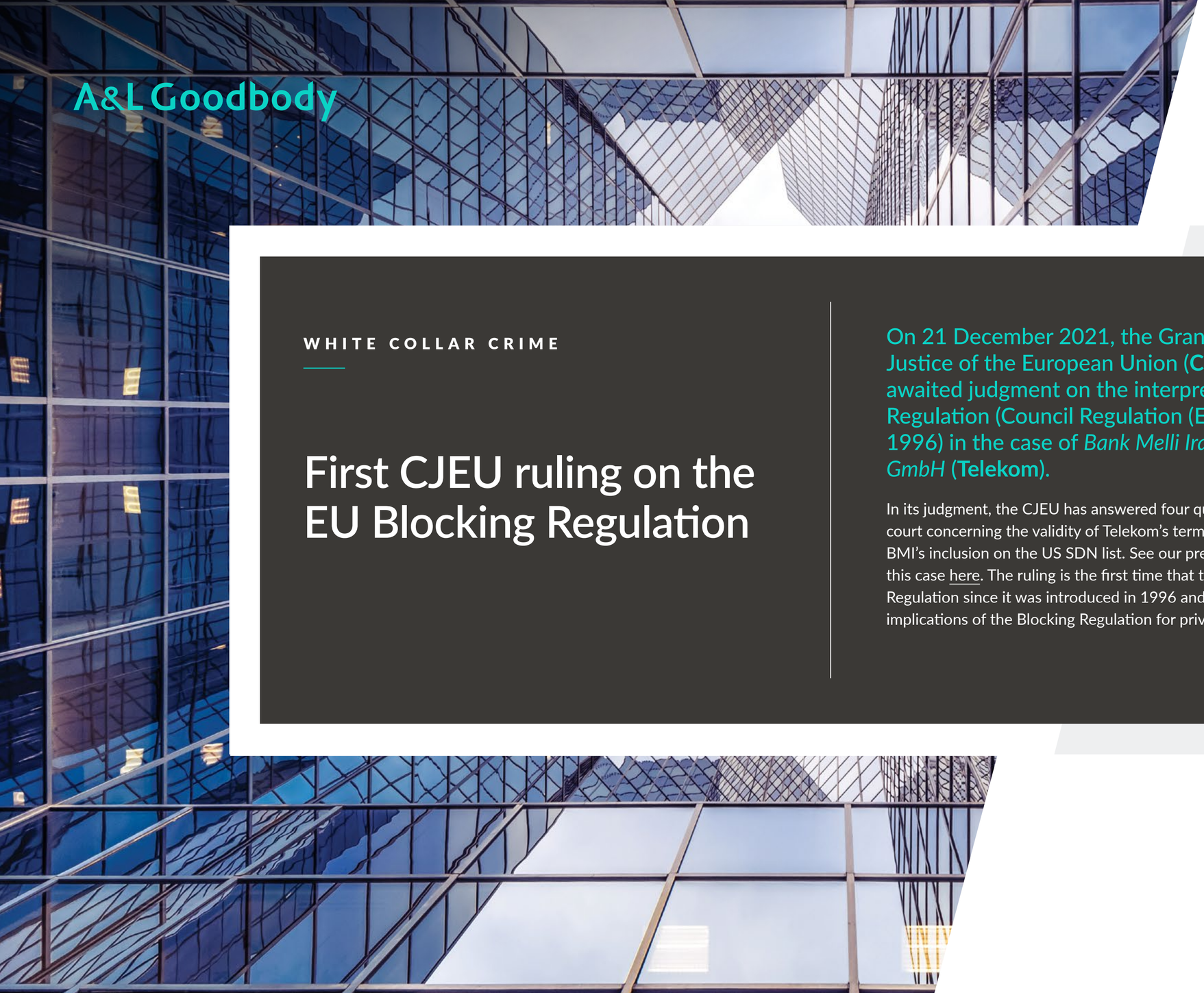


A&L Goodbody

WHITE COLLAR CRIME

First CJEU ruling on the EU Blocking Regulation

On 21 December 2021, the Grand Chamber of the Court of Justice of the European Union (**CJEU**) delivered its eagerly-awaited judgment on the interpretation of the EU Blocking Regulation (Council Regulation (EC) No 2271/96 of 22 November 1996) in the case of *Bank Melli Iran* (**BMI**) v *Telekom Deutschland GmbH* (**Telekom**).

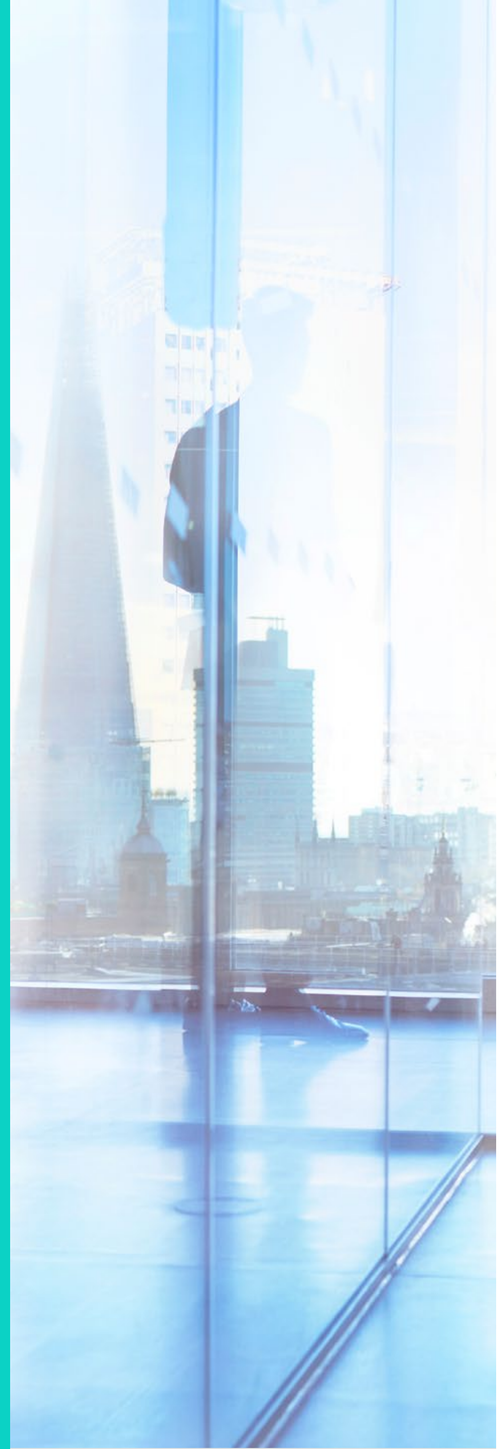
In its judgment, the CJEU has answered four questions referred by a German higher regional court concerning the validity of Telekom's termination of its contracts with BMI following BMI's inclusion on the US SDN list. See our previous discussion of the background to this case here. The ruling is the first time that the CJEU has interpreted the EU Blocking Regulation since it was introduced in 1996 and provides some useful guidance on the implications of the Blocking Regulation for private contractual arrangements.

7 MIN READ

EU Blocking Regulation

The EU Blocking Regulation aims to protect EU companies, nationals and residents by counteracting the extra-territorial application of economic sanctions by third countries, such as the United States, to EU operators. Specifically, Article 5 of the Blocking Regulation prohibits EU companies from complying, "*directly or through a subsidiary or another 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 relevant foreign sanctions. Authorisations are available under the Blocking Regulation for EU persons to comply fully or partially with the 'blocked' sanctions to the extent that non-compliance would seriously damage their interests or those of the European Union. Nevertheless, the tension between exterritorial US secondary sanctions, in particular, and the EU Blocking Regulation has caused many practical compliance challenges for companies with business interests in both continents attempting to comply with two conflicting regimes.

Advocate General Hogan delivered his opinion on this case in May 2021. Although he interpreted the Blocking Regulation in a broad manner he also noted that doing so gave him no pleasure, noting that "*the EU blocking statute is a very blunt instrument, designed as it is to sterilise the intrusive extraterritorial effects of US sanctions within the Union. This sterilisation method will inevitably bring casualties in its wake and many may think that Telekom Deutschland will be among the first to suffer, not least given its large US operations. As I have already hinted, these are matters which the EU legislature may well wish to ponder and consider*". Notably, the CJEU's ruling does not follow AG Hogan's strict interpretation of the Blocking Regulation on some key points. It also does not discuss the challenges caused by the Blocking Regulation or AG Hogan's comments on them.



CJEU ruling

In general, the CJEU's ruling provides some welcome clarity for EU operators when dealing with individuals or entities on the US SDN list. The key takeaways are:

1. The Blocking Regulation prohibits EU operators from complying with specified extraterritorial laws, even in the absence of a specific order from US authorities directing compliance.

The CJEU considered not just the broad wording of Article 5 but also its context and the objectives of the Blocking Regulation. Unsurprisingly, the CJEU held that the Blocking Regulation would not be capable of achieving its aims and counteracting US secondary sanctions if it were made conditional on the issuance of orders by US authorities. The position is simply that where the conduct of the EU operator is motivated by an intention to comply with the extra-territorial laws, it will breach the Blocking Regulation.

2. The Blocking Regulation can be relied upon in civil proceedings before EU member state courts.

The CJEU noted that EU operators are capable of giving effect to extra-territorial sanctions in the course of their commercial activities. Therefore, it must be possible to ensure compliance with the prohibition in Article 5 by means of civil proceedings. In this particular case, the proceedings had been initiated by a third country company against an EU company before the court of an EU member state.

3. The Blocking Regulation does not require an EU operator to provide reasons for terminating a contract with a person included in the SDN list.

Interestingly, the CJEU did not follow Advocate General Hogan's opinion on this point. He had opined that it follows from the uncompromising terms of Article 5 that – in principle, at least – an undertaking seeking to terminate an otherwise valid contract with an Iranian entity subject to US sanctions must demonstrate to the satisfaction of the referring court that it did not do so by reason of its desire to comply with those sanctions. AG Hogan felt that the Blocking Regulation would be compromised if "*the persons concerned were allowed to hide behind any vaguely credible reason for their decision*". However, the CJEU found that it is not clear from either Article 5 or any other provision of the Blocking Regulation that a person is required to give reasons for terminating a contract with a person on the US SDN list.

4. The burden of proof regarding the motivation for terminating the contract may be reversed in national civil proceedings.

Where the termination of a contract is motivated by purely economic considerations, it will not breach the Blocking Regulation. However, the evidence showing that an EU operator was motivated to terminate a contract in order to comply with extra-territorial sanctions is not normally available to a private complainant. To ensure the effectiveness of the Blocking Regulation, where the evidence before the Court indicates that an EU operator terminated a contract to comply with the 'blocked' extra-territorial laws, the burden of proof will shift to that EU operator to establish (to the requisite legal standard) that they were not seeking to do so.

5. National Courts may annul the termination of contracts by EU operators in order to comply with the terms of the EU Blocking Regulation, provided that that annulment does not disproportionately expose the EU operator to economic loss.

The Court clarified that if it were established that the ordinary termination by Telekom of its contracts with BMI was in breach of the Blocking Regulation then it would follow that the act of termination would be null and void. However, the Court noted that EU and national legislation must be assessed in light of the principle of proportionality under Article 52(1) of the Charter of Fundamental Rights of the European Union. In that assessment of proportionality, the Court held that it is necessary to balance, on the one hand, the objectives served by the annulment of the termination of a contract effected in breach of the Blocking Regulation and, on the other hand, the probability that the person concerned may be exposed to economic loss, as well as the extent of that loss, if the contract were required to be performed.

Interestingly, the Court did not follow AG Hogan's view on this point either. The AG had considered that in the event of a failure by an EU operator to comply with Article 5, the termination of the contract should be regarded as invalid and ineffective, requiring the national court to order specific performance of the contract by the EU operator.

Ultimately, the CJEU left it to the German higher regional court to decide where the balance lies, based on the CJEU's guidance. The CJEU specifically noted though that a factor that should be taken into account in this case is that Telekom had not applied for an authorisation under the EU Blocking Regulation before terminating its business relationship with BMI.

Commentary

Following this ruling, EU companies are reminded of the third party litigation risk of terminating contracts with individuals or entities in order to comply with US secondary sanctions and should position themselves accordingly. It also appears from the comments of the CJEU that where any EU business wishes to comply with US secondary sanctions, it should apply for an authorisation under the Blocking Regulation to do so. If this is not approved then the EU operator may be still justified in terminating contracts to comply with US sanctions if not doing so would lead to disproportionate economic loss. It will be a matter for national courts to determine whether the likely economic loss is severe enough to justify compliance with the specified US sanctions. EU businesses would be well advised to consider their potential exposure carefully and quantify any likely losses as far as possible before taking any action in breach of the Blocking Regulation.

Meanwhile, the European Commission is preparing amendments to the Blocking Regulation, expected to be adopted in the second quarter of 2022. The Commission previously indicated that the amendments would seek to (i) further deter and counteract the unlawful extra-territorial application of sanctions to EU operators by countries outside the EU and (ii) streamline the application of the current EU rules, including by reducing compliance costs for EU citizens and businesses. Developments on this front will be closely monitored by EU companies for further guidance on balancing the risks posed by the long reach of US sanctions with their EU law obligations.

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Resources

Interpreting the EU Sanctions Blocking Regulation: opportunity for guidance