Interpreting the EU Sanctions Blocking Regulation: *opportunity for guidance*

Companies caught in the crossfire between US sanctions against Iran and the EU's Blocking Regulation have found themselves manoeuvring in a precarious compliance zone.

The combined effect of the reinstatement of US sanctions against Iran and the EU's response in reactivating the Blocking Regulation have led to headaches for EU companies who have business exposure to both US and Iranian markets. In the first reference to the European Court of Justice (**ECJ**) on interpreting the Blocking Regulation, a German Court has posed a number of questions focused on the interplay between the EU and US sanctions regimes and the practical difficulties arising for EU companies.

An ECJ ruling in the case of *Bank Melli Iran v Telekom Deutschland GmBH*[1] should provide welcome clarification for businesses grappling with the challenges of either following US sanctions laws but potentially breaching the Blocking Regulation (Council Regulation (EC) No 2271/96) or vice-versa. Given the global clout of the US sanctions regime, EU operators complying with EU law in potential breach of US sanctions may be exposed to considerable economic losses. In addition, the EU's lack of enforcement of the Blocking Regulation stands in marked contrast to the aggressive enforcement policies and high fines imposed by US authorities. This combination of factors often leaves EU operators stuck between a rock and a hard place when making business decisions about their involvement with countries affected by international sanctions.

Background

Following its withdrawal from the Joint Comprehensive Plan of Action (the **JCPOA**) in May 2018, the US reinstated sanctions against Iran and introduced new sanctions, directed primarily at the financial, banking and oil sectors.

US secondary sanctions cast a wide net, applying even to non-US persons and without the need for a US nexus. They operate by threatening non-US persons with exclusion from US markets at varying levels. This would be calamitous for EU companies that make significant turnover or have significant business in the United States (as is the case for Telekom Deutschland). EU entities that are subject to these 'secondary sanctions' are prohibited under US law from providing goods, services or financing to Iranian persons and companies listed on the US' Specifically Designated Nationals and Blocked Persons List (the "**SDN List**"). Bank Melli was added to the SDN list once the US sanctions against Iran were reactivated on 5 November 2018, rendering EU operators who engaged in transactions with Bank Melli potentially subject to secondary sanctions.

The EU responded quickly to the extraterritorial application of the revived US sanctions laws by activating the Blocking Regulation "*to protect EU companies doing legitimate business with Iran from the impact of US extra-territorial sanctions*"[2]. The Blocking Regulation aims to achieve this by prohibiting compliance by EU entities with the US

[1] http://curia.europa.eu/juris/showPdf jsf?text=&docid=225701&pageIndex=0&doclang=EN&mode=req&dir=&occ=first&part=1&cid=11648

[2] Joint statement issued by the foreign ministers of the EU's member states. https://www.diplomatie.gouv.fr/en/country-files/iran/news/article/joint-statement-re-imposition-of-us-sanctions-due-to-its-withdrawal-from-the

sanctions on Iran. The first paragraph of Article 5 of the Blocking Regulation (**Article 5**) is widely drafted in providing that:

"*No [EU entity] 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.*"

The conflicting legal obligations arising from the intersection of the Blocking Regulation and US sanctions have required many businesses with interests on both continents to navigate a very difficult divide. According to official EU guidance, EU operators remain "*free to conduct business as they see fit*" and "*to choose whether to start working, continue, or cease business operations in Iran or Cuba, and whether to engage or not in an economic sector on the basis of their assessment of the economic situation*"[3]. Further, Article 5 provides a carve-out, allowing persons whose interests would be seriously damaged by non-compliance with US sanctions to seek authorisation from the EU commission to do so, in whole or in part.

However, there is a clear tension between EU and US sanctions laws and objectives. Some member states (including the UK and Ireland) have enacted legislation to criminalise compliance by EU operators with US sanctions against Iran, albeit the appetite for enforcement remains unclear. In addition, while there have been some cases on the interpretation of the Blocking Regulation at national level, there is a general dearth of EU jurisprudence in this area.

Case facts

This case arises from a dispute between Bank Melli Iran (an Iranian bank having a branch in Germany) and Telekom Deutschland GmbH (a leading German telecommunications service provider and subsidiary of Deutsche Telekom). Telekom Deutschland provided internet and phone services to Bank Melli in Germany.

Bank Melli was one of the Iranian entities placed on the US SDN List following the withdrawal by the US from the JCPOA. Shortly afterwards, Telekom Deutschland notified Bank Melli that it was terminating its contracts with Bank Melli with immediate effect. Telekom Deutschland also terminated contracts with nine other companies with links to Iran.

Bank Melli challenged Telekom Deutschland in the Hamburg Regional Court on the abrupt termination of its phone and internet services.

Both companies had significant commercial imperatives at stake in the dispute. For its part, Bank Melli argued that without the telecoms services provided by Telekom Deutschland, it would not be able to conduct business in Germany and that the effect of the contractual termination was tantamount to shutting its German operation. Set against this, Telekom Deutschland had 50,000 of its 270,000 employees located in the USA, 50% of its turnover was attributable to its US operations and the turnover made through its Bank Melli contracts amounted to a mere €2,000 per month.

The Hamburg Court did not accept the justifications put forward by Telekom Deutschland for terminating the contracts without notice. It was not disputed that Bank Melli had honored its contractual obligations to Telekom Deutschland until that point and had sufficient resources to continue doing so. Accordingly, the Court granted an injunction compelling Telekom Deutschland to perform its contract with the bank, pending expiry of the ordinary contractual notice provisions. Crucially, however, the Hamburg Court did accept that Telekom Deutschland could effectively terminate the contract with due notice without infringing Article 5.

The appeal

Bank Melli appealed the Hamburg judgment to the Hanseatic Higher Regional Court (the **Regional Court**), arguing that Telekom Deutschland's actions in seeking to terminate its contract on ordinary notice infringed Article 5 and was therefore ineffective.

[3] https://eur-lex.europa.eu/legal-content/SL/TXT/?toc=OJ%3AC%3A2018%3A277I%3ATOC&uri=uriserv%3AOJ.CI.2018.277.01.0004.01.ENG

Questions referred to the ECJ

On 5 March 2020, the Regional Court referred a number of questions to the ECJ for a preliminary ruling on the correct interpretation of Article 5.

1. What evidence is required to demonstrate that an EU operator has complied with a prohibited US sanction, i.e. is a US court or official order required or does reliance on the mere existence of secondary sanctions suffice?

Bank Melli argued that Telekom Deutschland had terminated its contracts in order to comply with US secondary sanctions. However, Bank Melli had not been able to point to any US court order or equivalent official direction obliging Telekom Deutschland to do so. Therefore, the question arose as to whether an EU operator would be in breach of the Blocking Regulation where it elected to comply with US sanctions laws, without being specifically directed to do so by a US official source.

In a decision from February 2020, Cologne's Higher Regional Court ruled that the answer to this question was no i.e. that Article 5 simply does not apply where the termination of a contract was not based on an official or court order issued directly to the EU operator. However, the Regional Court did not share that view; in its opinion, "*the mere existence of secondary sanctions suffices [to constitute a breach of Article 5], as only then can [the first paragraph of Article 5] be implemented effectively.*"

The Regional Court posed a number of further questions which flow from the answer to the first question.

2. If an official US order is not required for an EU operator to breach Article 5 by terminating a contract in reliance on secondary sanctions, then is it permissible for the EU operator to terminate a contract on ordinary notice, without giving reasons?

Several German courts have expressed the view that a party to a contract may exercise its contractually agreed right of ordinary termination of the contracts at any time without giving a reason. Cologne's Higher Regional Court expressly held in a ruling of 1 October 2019 that termination of a contract can '*be motivated by US foreign policy*'. However, while the Regional Court noted that this interpretation is possible, it took the view that it makes more sense to interpret it to mean that termination infringes the Blocking Regulation where its decisive motivation is compliance with US Sanctions. However, where the decision to terminate is based on other reasons, such as financial concerns, then termination would not result in infringement of Article 5.

3. If a party may not terminate a contract on ordinary notice without providing reasons, then would such a termination in breach of Article 5 be deemed void or would damages be an adequate remedy for the termination of the contract?

Penalties for breaching the Blocking Regulation are determined by each Member State. In Germany, the maximum fine for such a breach is €500,000. In this case, maintaining the business relationship with Bank Melli would expose Telekom Deutschland to considerable economic losses, as 50% of its turnover is linked to its US market. Therefore, the Regional Court, in taking a pragmatic approach, questioned whether it might be considered disproportionate to prevent Telekom Deutschland from terminating the contract rather than (only) imposing a fine.

In the circumstances, a fine capped at €500,000 would likely be the preferred outcome for Telekom Deutschland, rather than an order preventing termination of the contract. While this question goes to the core of the difficulties with the Blocking Statute, it may be difficult for the ECJ to answer this question in the broad terms in which it was phrased, given that criminal laws and penalties vary across EU Member States.

4. If termination of a contract on ordinary notice due to secondary sanctions is ineffective, would this still be the case where maintaining the business relationship with the SDN-listed party would expose the EU operator to considerable economic losses in the US market (in this case 50% of group turnover), bearing in mind:

- **the rights that are protected in the Charter of Fundamental Rights of the European Union (ECHR) (Article 16 (freedom to conduct a business) and Article 52 (the principle of proportionality))**
- **the possibility of obtaining an authorised exemption under Article 5 to comply with the US sanctions?**

The Regional Court noted that as the purpose of the Regulation is to prevent enforcement of secondary sanctions against EU operators, authorised exemptions would have to be granted on a somewhat restricted basis. Therefore, imminent economic losses alone might not provide sufficient grounds for an exemption. That said, the Regional Court had doubts over the compatibility of a general ban on severing relations with a business partner (let alone an insignificant business partner), in order to avert the risk of considerable losses to the US market, with the freedom to conduct a business protected under Article 16 ECHR and the principle of proportionality anchored in Article 52 ECHR.

It was further noted by the Regional Court that the Blocking Regulation was designed to protect EU operators and that this purpose may be defeated if Telekom Deutschland were forced to maintain a contract with Bank Melli and incur huge losses as a result.

Conclusion

An ECJ ruling on these questions has the potential to clarify the position for businesses attempting to negotiate both sides of the increasingly complex sanctions divide while also managing their potential exposure to penalties. This case presents the ECJ with an excellent opportunity to provide practical guidance to businesses facing this dilemma and developments in the case will be eagerly monitored.

For more information in relation to this topic please contact Kate Harnett, Associate, Louise Byrne, Associate or any member of the A&L Goodbody White Collar Crime team.

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