

Extraterritorial U.S. Sanctions and EU Blocking Rules: Damned If You Do, Damned If You Don't

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Court of Justice of the European Union sets Binding Rules on the Contractual Impact of the EU Blocking Regulation

The EU Blocking Regulation (the "Regulation")¹ prohibits compliance by EU persons with certain U.S. sanctions against Cuba and Iran. It particularly affects EU business since it was updated in 2018 when the U.S. left the 'nuclear deal' with Iran and enhanced its sanctions against that country. Today, the Court of Justice of the European Union (CJEU) delivered a judgment clarifying the impact of the Regulation on the termination of contracts by EU persons who intend to comply with U.S. sanctions.

The Regulation was drafted with a view to neutralising the extraterritorial effect of U.S. sanctions to protect EU persons from U.S. laws that contravene general principles of international law. However, in practice, the Regulation has seen little enforcement and few judgments of EU member state courts. As the final arbiter on the interpretation of EU law, the CJEU has today set important rules (which bind EU member state courts and arbitrators) on how the Regulation affects the termination of contracts.

The main takeaways from the CJEU's judgment are the following:

1. EU persons can be found in breach of the Regulation even if they voluntarily comply with U.S. sanctions and are not subject to any direct orders or enforcement proceedings by U.S. authorities.
2. EU persons terminating contracts with U.S. sanctioned parties are not obliged to disclose the reasons for termination if national law does not compel them to do so. However, if civil proceedings arise from the termination, the terminating party will be *prima facie* viewed as having terminated contractual relations in order to comply with U.S. sanctions and must prove that the termination was based on other reasons which do not violate Article 5 of the Regulation.
3. Specific performance is available as a remedy for parties using the Regulation as a cause of action, meaning that courts can order the reinstatement of contractual relations if it is found that the termination was in breach of the Regulation. However, such a decision must be supported by a proportionality test. EU member state

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courts must weigh how the invalidation of a termination serves the Regulation's objectives against the EU person's exposure to secondary sanctions and the EU person's ensuing economic losses if they would not be permitted to terminate the contract.

Background: The facts

Telekom Deutschland GmbH entered into a framework agreement for the provision of telecommunication services with the German branch of Bank Melli Iran. Following the U.S. withdrawal from the Joint Comprehensive Plan of Action, the U.S. Office of Foreign Assets Control reinstated its previously withdrawn sanctions against Iran, and Bank Melli was consequently designated (as a 'specially designated national' or SDN). Two weeks later, Telekom Deutschland terminated its contract with Bank Melli with immediate effect.

Bank Melli brought proceedings before the German regional courts claiming that this termination breached the Regulation. The German court of first instance ordered Telekom Deutschland to perform all obligations under the contract until the expiry of the ordinary notice period, viewing that ordinary termination by Telekom Deutschland (without cause and in line with the prescribed notice period) would be in accordance with the Regulation. On appeal by Bank Melli, the German regional appeals court availed itself of the preliminary reference procedure and referred questions relating to the interpretation of the Regulation to the CJEU.

In an opinion delivered in May 2021, Advocate General Hogan considered that the termination by an EU person of a contractual relationship with a party designated under U.S. sanctions should be regarded as invalid if it cannot be justified by the terminating party based on reasons other than compliance with U.S. sanctions.

In its judgment of today, the CJEU set out how parts of the Regulation should be interpreted.

Background: Key provisions in the Regulation

- Article 5(1) of the Regulation provides that no EU person shall comply with U.S. sanctions against Cuba or Iran (the U.S. laws and regulations set out in the Annex to the Regulation) "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."
- Article 5(2) provides that EU persons can, nonetheless, obtain an authorization from the EU Commission "to comply fully or partially to the extent that non-compliance would seriously damage their interests or those of the Community."
- The implementing regulation² (in respect of criteria for the consideration of such authorizations and the application procedure) provides, *inter alia*, for the following effects of U.S. sanctions to be taken into account for such an authorization:
 - "the adverse effect on the conduct of economic activity, in particular whether the applicant would face significant economic losses, which could for example threaten its viability or pose a serious risk of bankruptcy."

- “whether the enjoyment of the individual rights of the applicant would be significantly hindered.”
- Article 6 of the Regulation provides that any EU person “shall be entitled to recover any damages, including legal costs, caused to that person by the application of the laws specified in the Annex or by actions based thereon or resulting therefrom. Such recovery may be obtained from the natural or legal person or any other entity causing the damages or from any person acting on its behalf or intermediary.”

How this affects your business

The judgment does not materially alter the position for EU businesses with a U.S. nexus, which are still potentially caught by regulatory crossfire.

Reasons for termination in cases involving the potential application of U.S. sanctions against Iran (and Cuba) will now have to be more heavily scrutinised by EU member state courts and arbitrators. Consequently, having compelling internal policies governing the range of parties with which an EU person can transact with is fundamental, since being able to point to genuine anti-bribery and corruption, commercial, human rights and corporate social responsibility considerations may prove useful if the rescission of contracts is ever challenged in court.

If a challenge of a termination is to be expected, obtaining an authorization from the EU Commission can be considered as a tool to mitigate risk. However, in its judgment of today, the CJEU has not yet addressed how such an authorization would prevent the application of Article 6 of the Regulation, based on which the other party has a cause of action to recover damages caused by the termination. In view of a lack of enforcement of breaches of the Regulation in the EU, this raises the question of how much added value such an EU authorization actually provides.

Akin Gump has considerable experience with helping businesses devise and implement strong internal sanctions policies, both operationally as well as in contract clauses. We have a leading EU and U.K. sanctions and trade compliance team, including both EU and U.K. qualified lawyers in our London office who continuously counsel EU, U.S. and other (multinational) clients on navigating EU (and EU member state) and U.K. blocking rules and U.S. sanctions.

¹ Council Regulation (EC) No 2271/96 of 22 November 1996 protecting against the effects of the extra-territorial application of legislation adopted by a third country, and actions based thereon or resulting therefrom.

² 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.

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