Navigating EU Sanctions Blocking After Bank Melli V. Telekom

By Kevin Gaunt
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Russia's recent invasion of Ukraine has triggered a range of economic and financial sanctions imposed on Russia by jurisdictions around the world, most notably the U.S. and the European Union. While the recent coordinated sanctions against Russia by the U.S. and EU indicate that the interests of these two jurisdictions are often aligned, that alignment is not always a sure thing.

Many companies now operate in multiple jurisdictions around the world. This fact requires those companies to be aware of — and compliant with — export control laws and sanctions regimes in those jurisdictions.

When sanctions programs conflict, or when a jurisdiction's laws apply extraterritorially, companies face difficult decisions about how to manage transactions that might put them at risk for violating the laws of one or another jurisdiction.

There is a particular tension between the sanctions regimes in place in the U.S. and the EU. This tension is heightened in entities subject to both U.S. and EU sanctions regimes, such as multinational conglomerates with a presence in Europe and the Americas.

Compliance for those companies is complicated by the EU's so-called blocking statute, which was designed primarily to counteract the impact on EU persons of U.S. economic sanctions against Cuba and Iran.[1]

An opinion issued in a case of first impression by the Court of Justice of the European Union on Dec. 21, 2021, in Bank Melli Iran v. Telekom Deutschland GmbH, outlines a pragmatic approach for companies who are assessing the potential application of the blocking statute on their contractual obligations with counterparties who are subject to U.S. sanctions.[2]

While the CJEU's opinion provides guidance on the conditions applicable to terminating contracts and the possible consequences of violations of the blocking statute, substantive and practical questions remain that will likely result in continued uncertainty unless and until the EU amends the scope and application of the blocking statute.[3]

For the time being, then, companies subject to both U.S. sanctions and the blocking statute must walk the tightrope between the two regimes.

U.S. Sanctions

The U.S. government has numerous sanctions programs against targeted foreign countries and regimes,

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terrorists, international narcotics traffickers and other threats to U.S. national security, foreign policy or economic interests.

Most U.S. sanctions are administered and enforced by the U.S. Department of the Treasury's Office of Foreign Assets Control. U.S. sanctions can generally be divided into two categories: primary sanctions and secondary sanctions.

Primary sanctions prohibit U.S. persons from engaging in activity with a sanctioned person. A violation of U.S. primary sanctions can result in civil or criminal enforcement in the U.S.

Generally, under international law, a jurisdiction's laws are effective only in its own territory or on its own citizens — typically, where there is a direct nexus to the jurisdiction imposing sanctions.

For example, a non-EU foreign company might still be subject to an EU member's sanctions regime if it were undertaking business within that country. Similarly, an EU-headquartered company would continue to be subject to the relevant EU sanctions regime even though it might be conducting business outside the EU.

In some respects, however, U.S. law runs contrary to this position, and secondary sanctions have extraterritorial effect. Secondary sanctions authorize OFAC to impose sanctions on a non-U.S. person for certain activity, even if that activity took place outside the U.S. 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 levied against a non-U.S. person even if the transaction has no U.S. nexus — and is thus not subject to primary sanctions — and is legal in the jurisdiction in which the transaction takes place or the non-U.S. person operates. U.S. secondary sanctions thus dramatically increase the long-arm reach of U.S. jurisdiction.

For example, on Jan. 10, 2020, former President Donald Trump issued Executive Order No. 13902, which expanded U.S. secondary sanctions against Iran to include transactions involving the construction, mining, manufacturing and textiles sectors of the Iranian economy.[4]

The secondary sanctions in Executive Order No. 13902 mean that OFAC may sanction non-U.S. individuals and entities if they knowingly engage in a significant transaction for the sale or supply to or from Iran of significant goods or services used in connection with the specified Iranian sectors.

Executive Order No. 13902 also authorizes OFAC to sanction non-U.S. financial institutions that facilitate significant financial transactions involving those sectors.

EU Blocking Statute

In 1996, the EU countered U.S. sanctions against Cuba and Iran that were being applied by OFAC to subsidiaries of U.S. corporations located or operating in Europe by adopting a so-called blocking statute. The EU expanded the scope of the blocking statute in August 2018 when the U.S. withdrew from the Joint Comprehensive Plan of Action relating to Iran and implemented additional economic sanctions targeting Iran.

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The EU blocking statute applies to the following, defined collectively as EU operators:

- Any natural person who is a resident of the EU and a national of a member state;
- Any legal person incorporated within the EU;
- Any national of a member state established outside the EU and any shipping company established outside the EU and controlled by nationals of a member state, if their vessels are registered in that member state in accordance with its legislation;
- Any other natural person being a resident in the EU, unless that person is in the country of which they are a national; and
- Any other natural person within the EU, including its territorial waters and airspace, and in any aircraft, or on any vessel under the jurisdiction or control of a member state, acting in a professional capacity.

The blocking statute currently applies to limit the impact on EU operators of the following U.S. sanctions laws and regulations targeting Cuba and Iran, as set forth in the annex to the blocking statute:[5]

- The National Defense Authorization Act for Fiscal Year 1993, Title XVII of the Cuban Democracy Act, Section 1704 and Section 1706;
- The Cuban Liberty and Democratic Solidarity Act;
- The Iran Sanctions Act;
- The Iran Freedom and Counter-Proliferation Act;
- The National Defense Authorization Act for Fiscal Year 2012;
- The Iran Threat Reduction and Syria Human Rights Act;
- The Iranian Transactions and Sanctions Regulations at Title 31 of the Code of Federal Regulations, Part 560; and
- The Assets Control Regulations at Title 31 of the Code of Federal Regulations, Part 515.

The stated goal of the blocking statute is to counter the unlawful effects of third-country extraterritorial sanctions on EU operators, and to protect those EU operators engaging in lawful international trade and related commerce activities in accordance with EU law.[6]

The basic principle of the blocking statute is that EU operators must not comply with the sanctions listed in the annex, or annex sanctions, or any decision, ruling or award based thereon, because the EU does not recognize the annex sanctions' applicability toward the EU.

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The blocking statute achieves its goals by (1) nullifying the effect in the EU of any ruling of a foreign court based on or arising from annex sanctions; (2) allowing EU operators to recover in court for damages caused by the extraterritorial application of those laws; and (3) allowing EU operators to request authorization to comply with the annex sanctions if not doing so would cause serious harm to their interests or the interests of the EU.

An EU guidance note, issued to interpret and explain the blocking statutes, clarifies that EU operators are not obligated to do business with Iran or Cuba, but rather that they are:

Free to conduct their business as they see fit in accordance with EU law and national applicable laws. This means that they are free 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. The purpose of the blocking statute is exactly to ensure that such business decisions remain free, i.e., are not forced upon EU operators by the [annex sanctions], which the [EU] law does not recognize as applicable to them.[7]

The blocking statute also requires EU operators to inform the European Commission if the annex sanctions have directly or indirectly affected their economic or financial interests. The commission then uses these notifications to coordinate with the EU member state involved and to collect data on the impact of the annex sanctions on EU operators.

Between Aug. 1, 2018, and March 1, 2021, the commission received 63 notifications — 35 related to U.S. sanctions against Cuba and 28 related to U.S. sanctions against Iran. Also notable, the commission was notified of 10 legal proceedings within EU member states in which parties to civil litigation invoked the blocking statute as a basis for claims or defenses in the litigation.

The Sanctions Dilemma in Practice

In November 2018, the German branch of Bank Melli Iran was notified by Telekom Deutschland GmbH that Telekom was terminating its contract to provide telecommunication services to the bank. Bank Melli responded to the termination by filing a lawsuit in Germany asserting that Telekom's termination violated the EU blocking statute.[8]

Bank Melli argued that the notice of termination given by Telekom with respect to their contracts, which came shortly after the Trump administration reimposed sanctions on Iran, was invalid because the termination was motivated by Telekom's desire to comply with U.S. sanctions.

Telekom responded that it had the right to terminate the contract without disclosing its reasons and that German law did not require it to justify its rationale for terminating.

The German court presiding over the case then asked the CJEU to interpret the scope of the blocking statute. On May 12, 2021, CJEU Advocate General Gerard Hogan issued a preliminary opinion in the case.[9] Several points in his opinion were noteworthy.

One is that he found that the blocking statute's prohibition on compliance with specified third-country legislation imposing extraterritorial sanctions applies even where the actions constituting such compliance occur without having been compelled by a foreign administrative or judicial agency.

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In other words, the blocking statute applied even though Telekom had not been ordered by OFAC or any other agency to terminate the contract with Bank Melli.

Another key point was that an EU operator seeking to terminate an otherwise valid contract with an entity subject to the annex sanctions has the burden of proof to demonstrate that the termination is unrelated to compliance with the annex sanctions.

Additionally, the Hogan stated that if the national court of an EU member country finds that an EU operator has violated the blocking statute, the court should require specific performance of the contract in dispute — in addition to any other fines and penalties that may be levied.

The advocate general acknowledged the difficult circumstances imposed on companies by the conflict between the sanction regimes of the U.S. and the blocking statute.

As the facts of this case graphically show, the operation of the EU blocking statute gives rise to a series of hitherto unresolved legal issues and a variety of intensely practical problems, not least of which is that European companies find themselves facing impossible — and quite unfair — dilemmas brought about by the application of two different and directly opposing legal regimes. I cannot avoid observing that the nature of these dilemmas, together with the failure to provide clear guidance on important legal issues which directly arise from the operation of the EU blocking statute, is such that the EU legislature might with advantage review the manner in which that statute presently operates.

On Dec. 21, 2021, the CJEU issued its judgment, which largely tracks the reasoning of Hogan's preliminary opinion. The CJEU found:

- The blocking statute applies even without a specific order or guidance issued by OFAC or any other U.S. authority. An EU operator might breach the blocking statute by deciding on its own to comply with the annex sanctions or to take actions based on their potential impact.

- The blocking statute can be invoked in private litigation in the courts of EU member states — but this is without prejudice for EU member states to impose sanctions for breach of the blocking statute. In other words, both public and private enforcement of the blocking statute are permissible.

- EU operators can terminate contracts with a person blocked by U.S. sanctions without providing a reason, but if counterparties to the contract have evidence that the termination was based on the annex sanctions, the terminating party has the burden of proof to establish that the annex sanctions were not the basis and that it is not violating the blocking statute.

The CJEU reasoned that the blocking statute must be interpreted and weighed against the Charter of Fundamental Rights of the European Union when balancing the principle of freedom to conduct a business against the risk of disproportionate harm caused by enforcing the blocking statute.

When considering whether an annulment of the termination of a contract is appropriate — such as in the case of the Telekom termination — EU courts must consider whether annulment would result in "substantial economic loss as a result of that annulment."

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Courts are to assess proportionality between the pursuit of the blocking statute objectives that would be served by annulling the termination of a contract against the probability that the terminating party would be exposed to economic losses if it is unable to terminate its relationship with a party on OFAC's Specially Designated Nationals And Blocked Persons List.

The Bank Melli opinion likely portends changes regarding how the EU responds to U.S. secondary sanctions and enforces the blocking statute. Specifically, the CJEU's interpretation and holdings will likely strengthen the EU blocking statute and potentially penalize EU parties for adhering to U.S. sanctions laws.

Impact on International Businesses and Transactions

The potential repercussions of the dilemma outlined above could play out in a number of ways for foreign companies that have ties to both the U.S. and the EU.

A non-U.S. entity may comply with OFAC sanctions for any number of reasons. Perhaps it has an organizational nexus to the U.S., such as being a subsidiary of a U.S. company or having directors and officers who are U.S. persons. Perhaps it frequently enters into transactions that route through the U.S. financial system and that are denominated in U.S. dollars.

Or, perhaps it is simply adopting compliance with OFAC sanctions as a risk management measure in order to avoid potential issues with secondary sanctions or with potentially providing material support to a target of sanctions — and to avoid running the risk of itself being designated as a blocked person by OFAC.

In any of these scenarios, if the non-U.S. entity also has a nexus to the EU such that the blocking statute would apply — keeping in mind the broad scope of the blocking statute's definition of "EU operator" — then the non-U.S. entity will need to be mindful of being caught between the requirements of OFAC sanctions and the prohibitions of the blocking statute.

The CJEU's opinion in the Bank Melli case suggests that the EU may adopt a stringent interpretation of the requirements of the blocking statute, which would reinforce the dilemma faced by EU operators caught in the middle. Violating the EU blocking statute could give rise to criminal or administrative penalties, as well as possible civil litigation and damage claims that could be brought by affected parties — such as Bank Melli.

EU operators should also be prepared to explain business decisions involving Cuba or Iran by demonstrating that the decisions were not made solely to adhere to U.S. sanctions laws and to avoid violating the blocking statute.

And, if an EU operator is found to have terminated or otherwise violated an agreement because of the annex sanctions, it will then have the burden of establishing that the threat of substantial economic loss requires a court to find that annulment of the termination would have a disproportionate impact on it.

Contractual claims could also arise in cases involving wrongful termination of a business relationship. According to the CJEU's opinion, EU member state courts could conceivably order EU operators to maintain contractual relationships that the EU operators sought to terminate in violation of the blocking statute.

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Query, then, how OFAC would approach a situation whereby an EU operator was judicially ordered to continue a relationship with a blocked person? It is not clear whether the EU operator would be granted a license by OFAC, permitting the relationship to continue in spite of sanctions, or would need to appeal to the European Commission or the CJEU for relief pursuant to Article 5 of the blocking statute, because noncompliance with the OFAC sanctions would seriously damage their interests.[10]

Conclusion

Sanctions laws are a primary driver for the U.S. in shaping its foreign policy objectives. OFAC is aggressively pursuing enforcement of these laws and has expanded its extraterritorial reach significantly over the past few years. Companies with a nexus to both the U.S. and the EU should therefore take care to understand their obligations under both the U.S. sanctions programs and the EU blocking statute in order to avoid getting caught between the two.

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Notes

1. Council Regulation 2271/96, 1996 O.J. (L 309) 39.

2. Case C-124/20, Bank Melli Iran v. Telekom Deutschland GmbH, ECLI:EU:C:2021:1035 (Dec. 21, 2021).

3. The European Commission announced in August 2021 that it is considering amendments to the blocking statute, with a draft amended blocking statute to be released in the second quarter of 2022. See European Commission, Initiative, Unlawful extraterritorial sanctions – a stronger EU response (amendment of the Blocking Statute), https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13129-Unlawful-extra-territorial-sanctions-a-stronger-EU-response-amendment-of-the-Blocking-Statute-_en.

4. Executive Order 13902, 85 Fed. Reg. 2003 (Jan. 10, 2020).

5. Annex to Council Regulation 2271/96.

6. European Commission Guidance Note (2018/C 277 I/03) at FAQ 1.

7. European Commission Guidance Note (2018/C 277 I/03) at FAQ 5.

8. Case C-124/20, Bank Melli Iran v. Telekom Deutschland GmbH, ECLI:EU:C:2021:1035.

9. Case C-124/20, Bank Melli Iran v. Telekom Deutschland GmbH, ECLI:EU:C:2021:386 (Opinion of Advocate General) (May 12, 2021).

10. Blocking statute, Art. 5.

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