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The EU Commission Aims Its "Blocking Statute" at Renewed U.S. Sanctions Against Iran: What Will This Mean for EU Companies?

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On Tuesday, May, 8, 2018 President Donald Trump announced that the United States will no longer extend the waivers that have suspended U.S. sanctions against non-U.S. persons who do business with Iran, effectively declaring that the U.S. will be withdrawing from the 2015 6-party nuclear deal with Iran (the Joint Comprehensive Plan of Action or "JCPOA").

As one reaction to the U.S. move—which was vehemently opposed by all other parties to the deal—the European Union Commission has announced that it will reactivate the Council Regulation (CE) 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 resulting therefrom" (the "Blocking Statute" or the "Regulation"). If the legislation is in fact reactivated, EU companies could soon find themselves hoisted on the horns of a dilemma: either comply with the extra-territorial U.S. sanctions against Iran and face penalties under the EU Blocking Statute, or heed the Blocking Statute and face risk of severe consequences under U.S. law.

Unfortunately, this type of clash of laws (and the impossible situation to which they put companies seeking to comply) is not without precedent, and real damage can result whichever path a company takes. Fortunately, a showdown is not inevitable, and we anticipate that, in the end, the U.S. and the EU will not allow Iran to become the ground on which their foreign policies and attendant regulations engage in battle. Nonetheless, both EU companies and the counterparts with which they do business would be wise to pay attention and prepare, lest they become caught up in the fight.

I. The "Snap Back" of U.S. Secondary Sanctions

Prior to suspension under the JCPOA (provisionally in 2014 and then formally in 2016), the United States maintained an active program of so-called "secondary sanctions" exposing non-U.S. persons, including non-U.S. subsidiaries of U.S. companies, to punitive consequences if they did business in certain Iranian business sectors or with particular Iranian individuals and entities. Among other things, even non-U.S. persons who carried on targeted activities with Iran could be subject to a range of restrictions, including denial of U.S. Government benefits or approvals, access to U.S. lending markets, and even asset freezes. As part of its commitments under the JCPOA, the U.S. issued "waivers" of specified provisions and established a permissive licensing policy for U.S. persons seeking to engage in certain favoured activities, such as export of commercial aircraft. However, most "primary" sanctions—those applicable directly to U.S. persons—remained in place. The countries of the EU, for their part, removed most of their sanctions against Iran (with the exclusion of some specific restrictions still applicable, in connection with the violation of human rights and the anti-proliferation of nuclear weapons). As a result, many non-U.S. companies, including those in the EU, took steps to reactivate or newly establish business in Iran.

President Trump's decision of 8 May 2018, prospectively cancelling the waivers, will reinstate all U.S. sanctions suspended as part of the JCPOA, which had been aimed at preventing the Islamic Republic from developing nuclear weapons. The U.S. has also indicated that it will likely issue new sanctions against Iran, including those directed at Iran's continuing ballistic missile program. Reinstatement of the suspended sanctions will not be immediate. Instead, there will be "wind-down" periods of 90 or 180 days (depending on the sanctions program), running from 8 May 2018. (See our Client Alert of 8 May 2018 for more details.)

As recent OFAC enforcement actions suggest, implementation of renewed or expanded sanctions against non-U.S. persons is likely to be aggressive, taking advantage of broader theories of extra-territorial liability that have developed in recent years, even for companies with no U.S. operations. For example, OFAC has widened its enforcement net to target foreign companies that "cause" U.S. persons to violate sanctions by making U.S. dollar-denominated payments through the U.S. financial system to sanctioned jurisdictions or parties. The penalties imposed by the U.S. Government on this theory of liability can be considerable (the multi-billion dollar fines paid by European banks are emblematic of the magnitude of the risk).[1] Given the ever-broadening scope of liability, non-U.S. companies must be mindful of how the new sanctions could affect their business, should they elect to continue participating in the Iranian market after the applicable wind-down periods announced on May 8.

II. The Reaction of the European Commission: Activation of the "Blocking Statute" and Financial Assistance

As noted, in the wake of implementation of the JCPOA, European companies considerably increased their investments and trade relations with Iran. Those large bets now risk exposing the same companies to significant risk of sanctions by the U.S. Government. The potentially large economic effects of President Trump's decision have triggered a strong reaction from Brussels, including considerations of both countermeasures against the U.S. sanctions and protections for EU companies subject to them.

The European Commission is committed, in fact, to taking measures aimed at mitigating the impact of U.S. sanctions on European companies and sustaining economic relations between the EU and Iran, while still safeguarding the U.S.-EU relationship and maintaining the level cooperation with the U.S. in many sectors.

A. The Blocking Statute

In an aggressive move, the Commission triggered a formal procedure to activate the Blocking Statute, as a tool to mitigate the negative impact of the snap-back of U.S. secondary sanctions.

The Blocking Statute was originally introduced in 1996, in the context of the U.S. embargo on Cuba and of the sanctions relating to Iran and Libya. The Regulation was intended to provide protection and counteract the effects of the extra-territorial application of the foreign measures specified in the annex of the Regulation (the "Annex"), including regulations and other legislative instruments (the "Sanctioning Acts" including the U.S. measures relating to Cuba, Libya, and Iran at that time in place)[2] and of any actions based on or resulting from such instruments, where such application affects the interests of persons engaging in international trade and/or the movement of capital and related commercial activities between the EU and third countries (Article 1).

The Blocking Statute aims to discourage the imposition of U.S. sanctions on European subjects through disclosure mechanisms addressed to the European Commission (and therefore an escalation of the issue at the political level), to prohibit the enforcement of U.S. decisions, and provides a mechanism for an affected party to recover compensation. The expectation is that—as when it was introduced in 1996—the Blocking Statute would discourage the U.S. Government from imposing sanctions on European persons or entities.

For those Sanctioning Acts that have been added to the Annex, the Blocking Statute has broad application and broad implications.

The Blocking Statute applies to (i) any person resident in the EU and who has the citizenship of a Member State;[3] (ii) any entity incorporated within the EU; (iii) any natural or legal person referred to in Article 1 Para. 2 of Regulation (EEC) No. 4055/86;[4] (iv) any other natural person within the territory of the EU, unless that person is located in the country of which he is a national; and (v) any other natural person within the EU (including its territorial waters and air space and in any aircraft or on any vessel under the jurisdiction or control of a Member State, acting in a professional activity) (the "Protected Persons").

Where the economic and/or financial interests of any Protected Persons are affected—directly or indirectly—by the Sanctioning Acts or by actions based thereon or resulting therefrom, that person is obligated to inform the Commission within 30 days from the date on which it obtained such information. The reporting obligation applies to the directors, managers, and other persons with management responsibilities for a Protected Person (Article 2).

Furthermore, Article 4 of the Blocking Statute prohibits recognition or enforcement, in any manner, of any judgment of a court or tribunal and any decision of an administrative authority located outside the EU giving effect, directly or indirectly, to the Sanctioning Act or to actions based thereon or resulting there from. In other words, any measures with which sanctions were imposed under U.S. law cannot be enforced within the jurisdiction of the EU. Among other things, therefore, the assets belonging to the European entities subject to sanction cannot be subject to enforcement or seized when located in the EU. Of course, any property of any nature owned by sanctioned entity and located outside the EU would not receive the protection offered by the Blocking Statute.

Lastly, under the Blocking Statute, the Protected Persons and any other person who can establish damages shall be entitled to cover those damages (including legal costs) deriving from the Sanctioning Acts 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 (Article 6).

The current version of the Blocking Statute does not include, among the Sanctioning Acts, the recent U.S. secondary sanctions against Iran. To be extended to cover those measures, the Commission must undertake the process and notification steps outlined in footnote 2 above. Notably, the European Parliament and the Council have two months to object the measures proposed by the Commission before they enter into force. Any Member state has the right to object, and this would result in exclusion of the U.S. measures from the Blocking Statute.

Critically, the Blocking Statute has never been fully tested, and there is no case law or other references to rely upon in order to evaluate whether it will stand up to challenge if eventually mobilized against U.S. sanctions.

B. Other EU Protective Measures

The Commission has signalled that the European Investment Bank (EIB) will be empowered to providing financing for EU companies, particularly small- and medium-sized enterprises, to support continued investments in Iran. The Commission has also stated that it intends to strengthen ongoing cooperation and sectorial assistance related to Iran, including support for Iran's energy sector, and has also encouraged Member States to make possible wire transfers to the Central Bank of Iran. These measures are all aimed at facilitating and helping the Iranian government process oil-related revenues, in response to renewal of U.S. sanctions aimed at getting non-U.S. countries to reduce oil imports from Iran.

III. Conclusion

Many steps remain before there is an outright clash of regulations between the U.S. and the EU pertaining to continued business with Iran. Off-ramps remain. The U.S. could, in the name of renewing negotiations with Iran, agree to some carve-outs or extensions of relief from the effects of its secondary sanctions. EU Member States (such as the U.K., which has much to lose if its financial institutions cannot fully operate in the U.S. market) might elect to object to the addition of the U.S. secondary sanctions to the Blocking Statute. However, if the clash comes, many EU companies could be caught in the crossfire. Now is the time for these companies and their global counterparties to reassess the risks deriving from business relations with Iran or Iranian nationals/entities. In particular, now more than ever, the decision to continue, or to initiate, business relations with Iran or Iranian entities requires a careful check of the risks under U.S. sanctions (and measures in place to address those risks), as well as the impacts and consequences should the Blocking Statute be extended to the renewed or new U.S. sanctions against Iran.

Companies capable of correctly assessing and navigating these risks and obstacles will be best positioned to capitalize on the opportunities that inevitably will be presented by asymmetric application of U.S. and EU law in this complex landscape.

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[1] Between 2013 and 2015 alone, U.S. authorities imposed fines totaling over $US14 billion against violators of U.S. sanctions.

[2] The Commission is empowered to (i) add additional “Sanctioning Acts” to the annex, if have extraterritorial application and adverse effects on the interests of the Union and on the interests of persons and legal entities and (ii) delete Sanctioning Acts that no longer have any detrimental effect. The Commission’s action enters into force only if neither (i) the European Parliament nor the Council objects within the period of two months form notification of the action, or (ii) if, before the expiration of that deadline, both the European Parliament and the Council inform the Commission that they do not intend to raise objections. The period may be extended by four months on initiative of the European Parliament or the Council.

[3] Citizenship must have been legally established in the Community for a period of at least six months within the 12-month period immediately prior to the date on which an obligation arises or a right is exercised under the Blocking Statute.

[4] Council Regulation (EEC) No. 4055/86 of 22 December 1986 applies the principle of freedom to provide maritime transport services between Member States and between Member States and third countries. As under Article 1 Para. 2, the provisions of the Regulation is also applicable to the nationals of Member States established outside the Community and to shipping companies established outside the Community and controlled by nationals of a Member State, if their vessels are registered in that Member State in accordance with its legislation.