LATHAM&WATKINS

Client Alert Commentary

Latham & Watkins Export Controls, Economic Sanctions & Customs Practice

6 January 2022 | Number 2919

Top EU Court Clarifies Anti-US Sanctions "Blocking Statute"

The court explains how the controversial EU law operates to bar EU persons from complying with US sanctions on Iran and Cuba.

On 21 December 2021, the Court of Justice of the European Union (CJEU) released its long-awaited judgment in Case C-124/20. The case addressed questions that had arisen in legal proceedings between Bank Melli Iran (Bank Melli) and Telekom Deutschland GmbH (Telekom) that a German court had referred to the CJEU for clarification. The CJEU is the EU organ whose interpretations of EU acts is binding on EU Member States.

The CJEU's decision brings some clarity to the effect of a contentious piece of EU legislation, Council Regulation (EC) No. 2271/96, generally known as the "Blocking Statute". When a person operating within the EU seeks to terminate contractual obligations with a person subject to certain US sanctions targeting trade with Iran and Cuba, the CJEU confirmed:

1. The Blocking Statute provides a potential cause of action to a contractual counterparty when an EU operator terminates the contract in order to comply with certain US sanctions. Depending on the law of the relevant EU Member State, the affected person may bring civil proceedings for penalties that could include nullifying the termination or obtaining damages.

2. In such civil proceedings, the burden of proof may be reversed. If "*all the evidence available to a national court tends to indicate prima facie that, by terminating the contracts in question*, [*the EU operator*] *complied with the* [*US laws*]," then it is for the EU operator "*to establish to the requisite legal standard that his or her conduct did not seek to comply with those laws*."

3. If the national court accepts that an EU operator in this position terminated a contract because it sought to comply with relevant US sanctions laws, a national court can "weigh in the balance" whether the EU operator would suffer "disproportionate" economic loss if forced to reinstate that contract. An important factor for this assessment will be whether the EU operator applied to the European Commission for an authorisation to derogate from the Blocking Statute.

This *Client Alert* provides further details and commentary on these developments.

Background on the Blocking Statute

The Blocking Statute ostensibly aims to "protect" EU operators from certain US sanctions that have extraterritorial effect, including both US primary and secondary sanctions. Secondary sanctions are intended to dissuade non-US persons from engaging in certain dealings, such as with persons that US sanctions authorities have listed as Specially Designated Nationals (SDNs). US secondary sanctions carry the threat that non-US persons can be denied certain US benefits or be sanctioned themselves, including the potential threat of being barred from accessing the US financial system.

The Blocking Statute rests on the premise that such sanctions exert "extraterritorial" effect by purporting to regulate the activities of non-US persons outside of US territorial jurisdiction. The EU considers this to violate international law. The Blocking Statute responds by, *inter alia*, prohibiting EU operators from complying with the US sanctions laws against Cuba and Iran that the EU considers to have extraterritorial effect.

The Blocking Statute has only one derogation: it allows EU operators to comply with those US laws if they have obtained authorisation from the European Commission (the Commission) on the basis that non-compliance "*would seriously damage their interests or those of the* [*EU*]".

Although the Blocking Statute was passed in 1996, in practice it remained little used until 2018. That year, the US withdrew from the Iranian nuclear deal (also known as the Joint Comprehensive Plan of Action, or JCPOA) and re-imposed sanctions on Iran.

In response, the EU expanded the Blocking Statute to include prohibitions on complying with those sanctions. In addition, the Commission released Implementing Regulation 2018/1101, which explains how to apply for derogations, and a Guidance Note, which explains:

> "*EU operators 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 that such business decisions remain free, i.e., are not forced upon EU operators by the listed extra-territorial legislation, which the Union law does not recognise as applicable to them*."

The Blocking Statute is currently undergoing a consultation process for potential revision. The Commission's recent report on the initial stages notes that there is widespread dissatisfaction with various aspects of the regulation, including "*the vagueness of the language used*".

Background on the Case

Bank Melli is an Iranian bank that is owned by the government of Iran. It has been designated an SDN under US sanctions law.

Telekom is a subsidiary of the German telecoms group, Deutsche Telekom, which according to the CJEU derives about half of its business turnover from the US. Telekom had been servicing Bank Melli's German branch, but on 16 November 2018, Telekom notified Bank Melli of an early termination of all contracts. Telekom's notification and subsequent communications did not provide an explanation.

Bank Melli sought and obtained orders from the German courts for Telekom to service the contracts until the end of their original contractual periods. Bank Melli argued that it appeared Telekom had only terminated the contracts from a desire to comply with the revived US laws against Iran containing

extraterritorial effect. Under a provision of the German Civil Code, any legal act contrary to a statutory prohibition (which would include the Blocking Statute) is considered "*void except as otherwise provided by law*". Bank Melli maintained that this provision should ensure the nullification of Telekom's termination of the contracts.

Telekom appealed to the Higher Regional Court of Hamburg (the Referring Court), which raised several points for the CJEU on the basis of Telekom's arguments, including (i) Telekom was not the recipient of a direct order from a US authority obliging it to comply with the laws, and (ii) Telekom's reliance on the passage of the Commission's Guidance Note quoted above. For its part, Telekom suggested that nullifying the contractual termination would do the opposite of protecting it as an EU operator; in fact, it would expose Telekom to "disproportionate" economic harm and negate its fundamental freedom to conduct a business, as enshrined in the Charter of Fundamental Rights of the European Union.

The CJEU's Decision

The Referring Court raised four questions for the CJEU, which conflated the third and fourth questions and provided three answers. The passage below summarises the questions and answers.

Question 1: Does the Blocking Statute only apply where there is an order from a US authority directing compliance with a relevant US law?

No. The CJEU considered that the prohibition in the Blocking Statute was "broadly drafted". The Blocking Statute "*must be interpreted*" as prohibiting EU operators from complying with the relevant US laws "*even in the absence of an order directing compliance issued by* [US] *administrative or judicial authorities*".

Question 2: Does an EU operator have to provide a reason for terminating a contract with a person affected by the relevant US sanctions?

The CJEU answered this question in the negative, but with significant caveats. The CJEU found that there was no requirement in the Blocking Statute for an operator to provide reasons at the point of termination. However, the CJEU confirmed that the Blocking Statute can provide a cause of action to persons challenging such terminations.

The CJEU held that in order for national courts "*to ensure the full effectiveness*" of the Blocking Statute, "*it must be possible to ensure compliance with the prohibition* […] *by means of civil proceedings.*"

The CJEU explained that in the legal systems of many Member States (such as Germany), the burden of proof traditionally lies with the person alleging that a contract had been wrongfully terminated in order to comply with relevant US sanctions. The CJEU noted that this burden of proof might be "impossible or excessively difficult" to overcome, thus jeopardising the effectiveness of the Blocking Statute.

Accordingly, the CJEU directed the national courts of Member States that where "*all the evidence available to a national court tends to indicate prima facie that, by terminating the contracts in question,* [*the accused EU operator*] *complied with* [*the relevant US laws*]*, it was for that person to establish to the requisite legal standard that his or her conduct did not seek to comply with those laws*".

Questions 3 and 4: If the accused EU operator fails to prove that it did not terminate the contracts out of compliance with the relevant US laws, can a national court choose not to nullify the termination of the contracts if such a nullification risks exposing the EU operator to significant economic loss?

The CJEU noted that penalties under the Blocking Statute have not been harmonised, so it is for Member State national courts (or legislatures) to put in place penalties that meet the regulation's standard of being "effective, proportional and dissuasive". Member States may accordingly differ as to whether appropriate remedies will necessarily include nullification of contractual terminations or other measures, such as the issuance of fines.

The CJEU held that, in light of the Charter of Fundamental Rights of the European Union, the Blocking Statute could not be read in a way that ruled out the possibility of choosing not to nullify a contract if that nullification risked "disproportionate" economic losses (such as "threaten[ing] its viability or pos[ing] a serious risk of bankruptcy").

Accordingly, a national court will have scope to "weigh in the balance" the "probability" that the EU operator "*may be exposed to economic loss, as well as the extent of that loss, if that person cannot terminate his or her commercial relationship*". However, the CJEU indicated that an important factor in that assessment would be whether the EU operator applied to the Commission for an authorisation to derogate from the Blocking Statute.

Practical Impact

The CJEU's judgment provides important clarifications about the scope and nature of the Blocking Statute. In particular, it demonstrates that the Blocking Statute represents a clear legal bar to EU persons intending to take action to comply with US sanctions, including to terminate contracts with persons subject to US sanctions on Iran.

However, the judgment also leaves significant questions unanswered. For example, it remains unclear what level of economic risk and distress an EU operator must be able to demonstrate if it is to persuade a court not to nullify a contractual termination done in order to comply with US sanctions. It also remains unclear what level of evidence could be needed to demonstrate to a national court that, *prima facie*, an EU operator's contractual terminations do not appear to have arisen out of a wish to comply with US laws. It remains to be seen how Member state courts will translate this CJEU guidance into existing local civil procedure principles (like in Germany with respect to the principle of secondary burden of proof).

As to this, EU operators seeking further guidance may wish to consider the CJEU's decision in light of the comments of Advocate General Hogan. AG Hogan is one of a number of legal officers who are tasked with delivering non-binding and advisory "Opinions" that assess the facts of a case in light of EU law ahead of the CJEU's determinations. AG Hogan delivered the formal Opinion on this case in advance of the CJEU's judgment.

AG Hogan held the view that one manner in which an EU operator could demonstrate that it undertook termination other than in compliance with US sanctions would be if it could "*demonstrate that it is actively engaged in a coherent and systematic corporate social responsibility policy (CSR) which requires* [*it*]*, inter alia, to refuse to deal with any company having links with the Iranian regime*". Like the Commission's Guidance Note, AG Hogan's Opinion "*does not establish binding rules or legal interpretations*". Nonetheless, it could be considered to provide helpful context and suggests that EU operators may find practical value in being able to demonstrate their consideration of economic and moral concerns relating to human rights, anti-money laundering, and reputational risks.

Finally, the Blocking Statute is a piece of EU legislation that the UK has retained in English law (albeit adjusted so that derogation authorisations are to be sought from the Secretary of State of the Department for International Trade instead of from the Commission). Generally, post-Brexit, English courts are not

obliged to follow judgments of the CJEU. However, an English court operating in a similar context might find the CJEU's reasoning persuasive.

If you have questions about this *Client Alert*, please contact one of the authors listed below or the Latham lawyer with whom you usually consult:

Les P. Carnegie
les.carnegie@lw.com
+1.202.637.1096
Washington, D.C.

Charles Claypoole
charles.claypoole@lw.com
+44.20.7710.1178
London

Eric S. Volkman
eric.volkman@lw.com
+1.202.637.2237
Washington, D.C.

Robert Price
robert.price@lw.com
+44.20.7710.4682
London

Andrew P. Galdes
andrew.galdes@lw.com
+1.202.637.2155
Washington, D.C.

Joachim Grittmann
joachim.grittmann@lw.com
+49.69.6062.6548
Frankfurt

Elizabeth K. Annis
elizabeth.annis@lw.com
+1.202.637.1011
Washington, D.C.

Amaryllis Bernitsa
amaryllis.bernitsa@lw.com
+44.20.7710.4582
London

Ehson Kashfipour
ehson.kashfipour@lw.com
+1.202.637.2200
Washington, D.C.

Thomas F. Lane
thomas.lane@lw.com
+44.20.7710.3030
London

You Might Also Be Interested In

US Congress Passes Uyghur Forced Labor Prevention Act

UK Introduces New Global Anti-Corruption Sanctions Regime

Under Investigation: A GC Guide to White Collar and Sanctions Trends in 2021

Committee on Foreign Investment in the United States — Key Questions Answered on CFIUS
