First Reference to the European Court of Justice to Interpret the EU Blocking Statute in the Bank Melli Iran v. Telekom Deutschland GmbBH Case

July 1, 2020 - On March 5, 2020, a German regional court[1] lodged a request for a preliminary ruling before the European Court of Justice ("ECJ") in relation to the pending case between Telekom Deutschland and Bank Melli Iran for the termination of their contractual relationships following the re-imposition of U.S. secondary sanctions against the Islamic Republic of Iran ("Iran"). In the case, the German regional court referred four questions to the ECJ relating to the interpretation of the first paragraph of Article 5 of Regulation (EC) 2271/96 (the "EU Blocking Statute"), which prevents EU entities from complying with U.S. secondary sanctions. The decision of the European judges will hopefully provide long awaited clarification on the implementation of this heavily criticized regulation, whose practical scope is yet to be fully appreciated by companies and individuals subject to it.

EU and U.S. restrictive measures against Bank Melli Iran

- Former EU restrictive measures targeting Bank Melli prior to the JCPOA


As a result, on June 23, 2008, Bank Melli Iran, Iran's largest state owned bank, was included amongst the entities targeted by these freezing measures. The bank was designated because of its involvement in the provision of financial support for companies involved in or procuring goods for Iran’s nuclear and missile programs.
However, pursuant to the provisions of the Joint Comprehensive Plan of Action ("JCPOA") of July 2015, the EU Council decided on October 18, 2015 to suspend the restrictive measures targeting individuals and entities set out in Annexes V and VI of Decision 2010/413/CFSP (updating restrictive measures against Iran). As a result, Bank Melli Iran has not been subject to EU asset freeze measures since early 2016, when the JCPOA entered into force.

- **U.S. economic sanctions targeting Bank Melli**

Since 1979, the U.S. government has taken several major actions to sanction Iran’s support for terrorism, human rights violations, and, more recently, its development of nuclear capabilities. Since 1995, Iran has been subject to an embargo that effectively prohibits U.S. persons (including U.S. financial institutions) from virtually all transactions involving Iran (i.e., "primary sanctions"), but this embargo has generally not restricted non-U.S. companies. However, over the past few years, the U.S. has increased its deployment of extraterritorial "secondary" sanctions that can apply to non-U.S. companies transacting with Iranian parties identified on the Specially Designated Nationals And Blocked Persons List ("SDN List") administered by the U.S. Department of the Treasury, Office of Foreign Assets Control ("OFAC"). Notably, secondary sanctions can apply to transactions occurring entirely between non-US. Persons and without any connection to the United States. Non-U.S. persons entering into transactions with persons on the SDN List themselves could become subject to sanctions.

On October 25, 2007, the U.S. Department of the Treasury added Iran’s largest state owned bank, Bank Melli, to the SDN List for its alleged connections to the proliferation of weapons pursuant to Executive Order 13382. Eight years later, in 2015, in accordance with the terms of the JCPOA, the U.S. agreed, among other things, to lift most nuclear-related secondary sanctions against Iran and remove over 400 parties from the SDN List and other lists of sanctioned parties, although all primary sanctions would remain in effect. Consequently, on January 16, 2016 – the day the International Atomic Energy Agency verified that Iran implemented its nuclear-related commitments and the JCPOA was implemented – the U.S. Department of the Treasury removed Bank Melli from the SDN List. As a result, non-U.S. companies could transact with Bank Melli without a risk of secondary sanctions, although all U.S. persons and financial institutions continued to be prohibited from engaging in most transactions involving Bank Melli or Iran.

However, on May 8, 2018, President Trump announced United States’ withdrawal from the JCPOA and the re-imposition of U.S. nuclear-related secondary sanctions that had previously been lifted by the JCPOA. Thus, on November 5, 2018 – the date the sanctions previously waived under the JCPOA "snapped back" into effect – OFAC added Bank Melli back to the SDN List, thus freezing its assets under U.S. jurisdiction and making transactions involving Bank Melli and non-U.S. parties potentially subject to secondary sanctions.

Many business relationships between Bank Melli and its partners were, because of this designation, heavily impacted. In particular, on the same day the secondary sanctions snapped back into effect, the Society for Worldwide Interbank Financial Telecommunication ("SWIFT") announced that it was suspending access to its messaging system for certain designated Iranian banks, including Bank Melli, effectively cutting the bank off from most of the global financial system.

**The Bank Melli Iran v. Telekom Deutschland GmBH case**

A leading German telecommunications company, Telekom Deutschland, had previously entered into a framework agreement with the German branch of Bank Melli Iran and issued corresponding purchase orders to provide the bank’s internal and external communication structures in the country.

Following the United States’ withdrawal from the JCPOA, the German company gave notice of its immediate termination of all existing contracts with Bank Melli, as it had done with nine other entities with links to Iran. Telekom Deutschland’s grounds for termination with Bank Melli were the bank’s designation as a SDN and its
corresponding cutoff from the SWIFT financial messaging system. In particular, section 1(a)(iii) of Executive Order 13846, which re-imposed the U.S. sanctions waived under the JCPOA, authorizes OFAC to block the assets of any person determined to, “on or after November 5, 2018, [have] materially assisted, sponsored, or provided financial, material, or technological support for, or goods or services to or in support of... any Iranian person included on the list of Specially Designated Nationals and Blocked Persons.” Further transactions by Telekom Deutschland with Bank Melli therefore would risk Telekom Deutschland itself being added to the SDN list, which would have the effect of prohibiting U.S. parties from conducting business with it and denying it access to the U.S. financial system (e.g., transacting in U.S. dollars processed through a U.S. correspondent bank).

This cutoff led to the bank’s inability to conduct business through its German branch, and naturally raised doubts about the bank’s future solvency and potential payment default.

Bank Melli Iran sought relief before a German court of first instance by requesting the court to order that Telekom Deutschland maintain all contractually agreed lines active. The Regional Court of Hamburg ordered Telekom Deutschland to perform the existing contracts, but only until the end of the notice period provided in the contracts for ordinary termination. The court held, in particular, that the ordinary termination of the contested contracts by Telekom Deutschland after the notice period was observed was effective and did not infringe Article 5 of the EU Blocking Statute.

After the Regional Court of Hamburg issued its judgment, the defendant deactivated one of the lines in question, as the notice period for ordinary terminated had expired, on 10 February 2019.

In response, Bank Melli lodged an appeal against the judgment, arguing that the notice of ordinary termination given by Telekom Deutschland infringed the EU Blocking Statute and was therefore ineffective.

The Hanseatic Higher Regional Court, now entrusted with the case, had to decide (i) whether the Telekom Deutschland was entitled to terminate the contract and (ii) whether such termination infringes the EU Blocking Statute.

**The EU Blocking Statute**

Twenty-three years ago, to mitigate the extraterritorial reach of U.S. economic sanctions against Cuba as provided in the Helms-Burton Act of 1996, the EU Council adopted the Regulation (EC) 2271/96 of November 22, 1996 protecting against the effects of extra-territorial application of legislation adopted by a third country and actions based thereon or resulting therefrom. The European Union adopted this piece of legislation to protect EU entities from the adverse consequences of the extraterritorial reach of U.S. secondary sanctions by preventing them from complying with U.S. secondary sanctions.

Following the United States’ withdrawal from the JCPOA, and to mitigate the impact of U.S. secondary sanctions on the interests of EU companies doing legitimate business with Iran, the European Union amended its Blocking Statute. To this end, the Commission adopted the Delegated Regulation (EU) 2018/1100 on June 6, 2018, which expands the scope of the Blocking Statute to include U.S. sanctions against Iran that were either lifted or waived under the JCPOA as well as any actions based thereon or resulting therefrom.

The effectiveness of the EU Blocking Statute rests upon Member States’ actions to pass legislation with deterrent effect prohibiting any infringement of the EU Blocking Statute as well as actively prosecuting such infringements. However, only a few Member States have actually passed legislation to this end (e.g., the United Kingdom considers its infringement as a criminal offense). Therefore, since its enactment, the EU Blocking Statute has been widely regarded as ineffective due to its lack of enforcement. When confronted with a choice between complying with U.S. secondary sanctions and breaching the EU Blocking Statute, EU companies tend to choose the former.
based on OFAC’s aggressive enforcement policy, the potential for being added to the SDN list, and resulting significant fines levied against EU companies for breaching U.S. sanctions provisions. EU companies have shown that they would rather take the risk of infringing the EU Blocking Statute (and incur comparatively minor penalties) by withdrawing from the Iranian market rather than facing the consequences of being designated as a SDN (i.e., exclusion from the U.S. financial system and prohibition to deal with U.S. persons, a potentially existential threat to many global companies) pursuant to secondary sanctions provisions.

**Proceedings before the European Court of Justice**

On March 2, 2020, in the matter between the German branch of Bank Melli Iran and Telekom Deutschland, the Hanseatic Higher Regional Court requested the ECJ to issue a preliminary ruling. Pursuant to the Treaty on the Functioning of the European Union ("TFEU"). As a result, the proceedings before the Higher Regional Court are stayed and the preliminary ruling requested from the ECJ before judgment is to be delivered on Bank Melli’s appeal[5]. As such, the ECJ’s interpretation of Article 5 of the EU Blocking Statute ECJ is a prerequisite to solving the dispute at hand.

Bank Melli specifically argues that the termination of its contracts with its German counterparty is ineffective, as it infringes the first paragraph of Article 5 of Regulation (EC) 2271/96, which provides:

“No person referred to in Article 11 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."

Article 11 states that the Regulation shall apply, in particular, to “any legal person incorporated within the Community’ and all the instruments listed in the Annex are U.S. acts and regulations against Iran, Cuba and Syria.

In other words, and as the Commission stated in a Guidance Note dated August 7, 2018, regarding the amendment of the EU Blocking Statute, EU entities (like Telekom Deutschland ) are required not to comply with the listed extra-territorial acts, regulations or any decision, ruling on or based thereon, given that the European Union does not recognize their effects.

Therefore, the Hanseatic Higher Regional Court referred four questions that will enable the judges to decide whether ordinary termination by Telekom Deutschland infringes the first paragraph of Article 5 of the EU Blocking Statute and whether the termination is or not effective.

**Questions referred to the European Court of Justice on the implementation of Article 5 of the EU Blocking Statute**

1. Does the first paragraph of Article 5 of the EU Blocking Statute only apply where the acting EU operator is issued directly or indirectly with an official or court order on the part of the United States or does it suffice for its application that the action of the EU operator is predicated on compliance with secondary sanctions without any such order?

In other words, does the EU Blocking Statute only apply if the notice of termination follows a direct or indirect official or court order from the United States?

As for now, the Hanseatic Higher Regional Court considers that the mere existence of secondary sanctions suffices for the first paragraph of Article 5 to apply. Therefore, for the German regional court, Telekom
Deutschland did not need to justify its notice of termination with an official or court order for the EU Blocking Statute’s ban to apply.

There is the hope that the ECJ clarifies whether a U.S. official or court order is a prerequisite to the application of the EU Blocking Statute. Such position from the ECJ would again considerably hinder the efficiency of the EU Blocking Statute by drastically narrowing its scope.

- **2. If the answer to Question 1 is that the second alternative applies:** Does the first paragraph of Article 5 preclude an understanding under national law that the party giving notice of termination is also able to terminate a continuing obligation with a contracting party named on the SDN List, including where termination is motivated by compliance with U.S. sanctions, without the need to give a reason for termination and therefore without having to show and prove in civil proceedings that the reason for termination was not to comply with U.S. sanctions?

In other words, is Telekom Deutschland in breach of the EU Blocking Statute by giving notice of termination without stating that it is grounded upon compliance with U.S. sanctions?

According to the Commission’s Guidance Note of August 7, 2018, EU operators are “free to choose whether to start working, continue, or cease business operations in Iran or Cuba” since EU law does not recognize the listed extraterritorial regulations. Therefore, several German courts consider that an EU operator can exercise its right of ordinary termination of contracts at any time without justification. In our case, this would mean that Telekom Deutschland was free to give a notice of termination to Bank Melli for commercial or financial reasons at any time without the need to provide any explanation.

The Hanseatic Higher Regional Court considers that a termination strictly based upon compliance with U.S. sanctions would indeed infringe Article 5 of the EU Blocking Statute. It further adds that, a termination due to non-sanctions-related motives would be lawful. Consequently, in case of uncertainty related to the motives of termination, Telekom Deutschland should explain the reason behind its notice of termination to avoid any doubt about a potential breach of the EU Blocking Statute.

This interpretation of Article 5 of the EU Blocking Statute would be in line with the purpose of the EU Blocking Statute and would prevent its misuse by foreign entities to challenge ordinary notice of termination based on purely commercial or financial motives. The purpose of the EU Blocking Statute is to serve as a shield for EU operators against the adverse consequences of the extraterritorial reach of U.S. secondary sanctions and not as a sword by foreign entities to challenge lawful terminations based solely on business motives.

- **3. If Question 2 is answered in the affirmative:** Must ordinary termination in breach of the first paragraph of Article 5 necessarily be regarded as ineffective or can the purpose of the Regulation be satisfied through other penalties, such as a fine?

In other words, would a termination in contravention of Article 5 shall automatically be considered void (i.e., the contracts would continue to be in force)? Or would the payment of penalties also be sufficient to serve the purpose of the EU Blocking Statute.

Article 9 of the EU Blocking Statute states that “Each Member State shall determine the sanctions to be imposed in the event of breach of any relevant provisions of this Regulation. Such sanctions must be effective, proportional and dissuasive.” In that regard, German civil law provides that termination in breach of the first paragraph of Article 5 of the EU Blocking Statute is ineffective and constitutes an administrative offense subject to fine of up to EUR 500,000.
The Hanseatic Higher Regional Court adopts a pragmatic approach, considering that, in light of the economic losses to which Telekom Deutschland is exposed if it is excluded from the U.S. market, it might be considered disproportionate to prevent it from terminating its contractual relationships with Bank Melli rather than only imposing a fine.

We agree with the German regional court’s understanding, even though it seems unlikely that the ECJ will decide on the nature of the penalty for breaching the EU Blocking Statute as such decision falls under the remit of EU Member States. This raises the larger issue of the differences in the measures adopted by EU Member States to punish violations of the EU Blocking Statute. A unified solution taking the form of an EU guidance (issued by RELEX for example) as to the preferred sanction for breach of the EU Blocking Statute would be recommended, even though this may infringe upon Member States’ authority over criminal matters. Without such guidance, it is likely that the main criticisms about the EU Blocking Statute concerning its lack of enforcement by Member States will remain and proliferate.

- 4. If the answer to Question 3 is that the first alternative applies: Considering Articles 16 and 52 of the Charter of Fundamental Rights of the European Union, on the one hand, and the possibility of an exemption being authorized under the second paragraph of Article 5, on the other, does that apply even where maintaining the business relationship with the listed contracting party would expose the EU operator to considerable economic losses on the U.S. market (in this case: 50% of group turnover)?

In other words, if the termination of contracts is considered ineffective pursuant to the EU Blocking Statute, would the purpose of the EU Blocking Statute (which is to protect EU firms) not be defeated if maintaining the contractual relationships with Bank Melli (to comply with the EU Blocking Statute) exposes Telekom Deutschland to important economic losses in the U.S. market?

As stated above, the EU Blocking Statute is a shield to protect EU firms and is not intended to protect foreign companies such as Bank Melli. This case illustrates the dilemma that EU firms are facing when they have significant business both in the U.S. and in a country subject to U.S. secondary sanctions. They are indeed stuck between the hammer (respect of U.S secondary sanctions provisions and as such termination of their contractual relationship to avoid being designated as SDN) and the anvil (compliance with the provisions of the EU Blocking Statute).

The German regional court further adds that should the EU firm decide to comply with EU law and therefore maintain its relationship with the Iranian counterpart, its considerable economic loss deriving from the potential designation as a SDN would not be made back by the recovery claim regulated in Article 6 of the EU Blocking Statute. As such, the deterrent effect of U.S. secondary sanctions for companies with an important turnover or presence in the United States is stronger than the potential economical relief granted by Article 6 of the EU Blocking Statute. Which also weakens the efficiency of the EU Blocking Statute.

The EU Blocking Statute additionally offers EU firms facing such a dilemma the possibility to request an authorized exemption allowing them to comply with U.S. regulations. It is however safe to assume that the issuance of such waivers, which empty the EU Blocking Statute of its substance, is strictly limited. Therefore, imminent economic loss may not be considered as sufficient grounds for an exemption.

The Hanseatic Higher Regional Court also exposed the inherent conflict between the risk of considerable economic loss on the U.S. market stemming from a violation of U.S secondary sanctions and the freedom to conduct a business, protected under Article 16 of the Charter of Fundamental Rights of the European Union as well as the principle of proportionality anchored in Article 52 of the same Charter.
This last question raises several interesting issues and sheds light on the quagmire in which EU firms are stuck in the crossfire between (i) compliance with directly applicable EU law (the breach of which is not significant from an economic standpoint) and (ii) the adverse consequences of being designated as a SDN for violation of U.S. secondary sanctions and corresponding economic losses on the U.S market. Hence, once again, pragmatic and meaningful guidance from the EU or the ECJ itself should be issued to take into consideration the economic context surrounding the EU operators facing similar situations.

**Conclusion**

The ECJ’s decision on the interpretation of the first paragraph of Article 5 of the EU Blocking Statute may have a great influence on the future business-management of EU companies. This request is indeed the first time that the European judges are asked to provide their general understanding and views on the implementation of the EU Blocking Statute.

The decision illustrates well the dilemma that EU companies face when they have significant turnover/business in the United States or otherwise deal in U.S. dollars and are conducting at the same time business in countries subject to U.S. secondary sanctions. This dilemma is not a hypothetical one and has, as this case illustrates, strong business implications and consequences notably concerning the future of existing contracts with entities designated as SDNs by the United States. EU companies should not be kept alone in the dark without specific guidance to weigh these two risks.

This case sheds light on the major flaws inherent to the EU Blocking Statute, namely its lack of effectiveness and the differences among EU Member States concerning the implementation, content and enforcement of national legislation sanctioning the infringement of the EU Blocking Statute. Indeed, in the absence of a unified and clear framework at EU level, the current situation is likely to lead to forum shopping among Member States, with some countries offering more protection against the adverse consequences of U.S. secondary sanctions than others.

The ECJ has a rare opportunity in this instance to clarify its position and propose a unified approach as well as issue pragmatic and long awaited guidance to EU businesses. The expectations are very high and this instance is a great opportunity offered to the ECJ to meet them.

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[1] The Hanseatisches Oberlandesgericht (Hanseatic Higher Regional Court) is the Higher Regional Court of the Free and Hanseatic City of Hamburg, Germany, and part of the Hamburg ordinary jurisdiction.

[2] First paragraph of Article 5 of Regulation (EC) 2271/96 states that “No person referred to in Article 11 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.”

[3] The Landgericht Hamburg (Regional Court of Hamburg) is the Regional Court of the Free and Hanseatic City of Hamburg, Germany, and part of the Hamburg ordinary jurisdiction.


[5] First paragraph, point (b), and the third paragraph of Article 267 of the Treaty on the Functioning of the European Union.

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