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Referrals to the ECJ in 2020 to Clarify the Scope of several European Regulations on Economic Sanctions

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This article is the first part of a review on the scope of EU regulations in cases relating to economic sanctions against Iran. The second part (dealing with the recent request for a preliminary ruling by the French Supreme Court on this subject) will be published shortly on our website.

In the past few months, EU member-state courts have referred several questions to the European Court of Justice (ECJ) to rule on the scope of EU Regulations in cases raising issues relating to economic sanctions against Iran. In a first instance, in March 2020, a German court asked the ECJ to rule on the scope of the first paragraph of Article 5 of Regulation (EC) No. 2271/96, invoked to terminate a commercial relationship between a German company and an Iranian bank following the re-imposition of secondary U.S. sanctions against Iran. In a second instance, the French *Cour de Cassation* referred a case to the ECJ in July 2020 to determine whether a seizure order can be issued against assets frozen pursuant to an EU asset freeze measure. This two-part article, will analyze in turn these two cases to present the issues at stake for which a clarification is sought from the ECJ. The first part of this article focuses on the questions referred to the ECJ by the German court.

On March 5, 2020, a German regional court[1] made a request to the ECJ for a preliminary ruling in the case between Telekom Deutschland and Bank Melli Iran concerning the termination of their contractual relationship following the re-imposition of U.S. secondary sanctions against the Islamic Republic of Iran ("Iran"). In this case, the German regional court referred four questions to the ECJ concerning the interpretation of Article 5 (1) of Regulation (EC) No. 2271/96 (the "European Blocking Staute"), which prohibits European entities from complying with U.S. secondary sanctions.[2] The ruling by the European Court will hopefully provide much-needed clarification on the implementation of this much-criticized regulation, whose practical scope is not yet fully appreciated by the companies and persons subject to it.

1. Restrictive measures adopted by the European Union and the United States against Bank Melli Iran

a. Previous EU economic sanctions against Bank Melli Iran prior to the Vienna Accords

In order to put pressure on Iran to halt sensitive proliferation activities and development of nuclear weapon delivery systems, the European Union ("EU") enacted United Nations Security Council Resolution 1737 (2006) into Community law by adopting Common Position No. 2007/140/CFSP on February 27, 2007 and Regulation (EC) No. 423/2007 on April 19, 2007. This Regulation establishes, *inter alia*, a list of persons and entities subject to asset freezing measures.

It is within this framework that on June 23, 2008, Bank Melli Iran, the largest state-owned Iranian bank, was hit by these asset-freezing measures. The bank was designated because of its involvement with and financial support provided to companies involved in Iran's nuclear and missile programs.

However, in accordance with the Vienna Agreement on Iran's nuclear program concluded on July 14, 2015, (the "Vienna Agreement"), the Council decided, *inter alia*, on October 18, 2015, to suspend the sanctions freezing the assets of the persons and entities listed in Annexes V and VI to Decision 2010/413/CFSP (the latter updated the sanctions against Iran), including those of Bank Melli Iran.

b. U.S. economic sanctions against Bank Melli Iran

Since 1979, the U.S. government has adopted several measures to punish Iran's support for terrorism, human rights abuses and, more recently, the development of its nuclear capabilities. Since 1995, Iran has therefore been subject to an embargo that, in practice, prohibits U.S. Persons (including U.S. financial institutions),[3] from conducting any transactions with Iran (these sanctions applicable to U.S. persons are also called "primary sanctions"). Non-U.S. persons are not impacted by these measures. However, over the past decade, the United States has increased the extraterritorial, or "secondary", sanctions that may apply to non-U.S. persons conducting transactions with Iranian counterparties on the Specially Designated Nationals And Blocked Persons List (the "SDN List") administered by the U.S. Treasury Department's Office of Foreign Assets Control (the "OFAC"). Secondary sanctions may apply, *inter alia*, to transactions that have no jurisdictional connection with U.S. territory.

Accordingly, on October 25, 2007, the US Treasury Department added Iran's largest public bank, Bank Melli, to the SDN List under Executive Order 13382 because of its alleged role in the proliferation of nuclear weapons in Iran. Under the terms of the Vienna Agreement, the U.S. agreed, among other things, to lift most secondary nuclear-related sanctions and remove more than 400 names from the SDN List and other sanctioned persons lists. The primary sanctions stayed in place however. It is in this context that on January 16, 2016, the day on which the International Atomic Energy Agency (the "IAEA") monitored Iran's compliance with its nuclear proliferation commitments and the day on which the Vienna Agreement entered into force, the U.S. Treasury Department removed Bank Melli from the SDN List. From then onwards, non-US persons could conduct transactions with Bank Melli without running the risk of designation under secondary sanctions. Transactions involving Bank Melli or Iran, however, remained prohibited for U.S. persons and financial institutions.

However, on May 8, 2018, President Trump announced the United States' withdrawal from the Vienna Agreement and reinstated secondary U.S. sanctions related to nuclear proliferation. Accordingly, on November 5, 2018, the date on which the sanctions previously lifted under the Vienna Agreement were reinstated, OFAC reinstated Bank Melli on the SDN List, thereby freezing its assets under U.S. jurisdiction and exposing any non-U.S. person having a business relationship with Bank Melli to a risk of designation under the secondary sanctions.

Numerous business relationships between Bank Melli and its partners have been significantly affected as a result of this designation. For example, on the same day that the sanctions were reinstated, the Society for Worldwide

Interbank Financial Telecommunication ("SWIFT") announced that it was suspending access to its payment messaging system for certain designated Iranian banks, including Bank Melli, thereby cutting Bank Melli off from most of the global financial system.

2. The Banque Melli Iran v. Telekom Deutschland GmBH case

The German company Telekom Deutschland, a leader in the telecommunications sector, had entered into a framework agreement with the German branch of Bank Melli Iran for provision of internal and external communication structures for the Iranian bank in the country.

Following the United States' withdrawal from the Vienna Agreement, Telekom Deutschland gave notice of the immediate termination of all its existing contracts with Bank Melli, as it had done with nine other entities with ties to Iran. The reason for termination was given as the bank's designation as an SDN and its subsequent exclusion from the SWIFT payment messaging system. Article 1(a)(iii) of Executive Order 13846, which reinstated the U.S. sanctions lifted under the Vienna Agreement, also authorizes OFAC to freeze the assets of any person when it is established that, "*on or after November 5, 2018, the person has 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*".[4] Any new transaction between Telekom Deutschland and Bank Melli exposes the German company to the risk of being designated on the SDN List, which would have the effect of prohibiting U.S. persons from conducting transactions with it and would close off its access to the U.S. financial system.

Termination led to the bank being unable to maintain activity at its German branch and has naturally raised doubts as to the bank's future solvency and therefore a potential default on its payments.

Bank Melli Iran therefore filed an action for damages before the German Court of First Instance, seeking an order requiring Telekom Deutschland to maintain all active telecommunication lines. The Hamburg Regional Court ordered Telekom Deutschland to perform the current agreements only until the end of the ordinary notice period. In particular, the court held that the termination of the disputed contracts was lawful and did not violate Article 5 of the European Blocking Statute.

Following the judgment of the Hamburg Court, Telekom Deutschland deactivated one of the lines in question as the notice period had expired on February 10, 2019.

In response, Bank Melli appealed this judgment, arguing that the termination violated the European Blocking Statute and therefore had no effect.

The Hanseatic Higher Regional Court, now overseeing the case, therefore has to determine (i) whether Telekom Deutschland was entitled to terminate the agreement, and (ii) whether such termination violates the provisions of the European Blocking Statute.

3. The European Blocking Statute

Twenty-three years ago, in order to counter the extraterritorial scope of U.S. economic sanctions against Cuba, imposed under the 1996 Helms-Burton Act, the European Council adopted Regulation (EC) 2271/96 of November 22, 1996. The EU adopted this regulation in order to protect European entities from the negative consequences of the extraterritorial scope of U.S. secondary sanctions by prohibiting them, with certain exceptions, from complying with these sanctions.

Following the United States' withdrawal from the Vienna Agreement, and in order to mitigate the impact of U.S. secondary sanctions on the interests of European companies that have legitimate business activities with Iran, the EU amended its Blocking Statute. On June 6, 2018, the Commission adopted Delegated Regulation (EU) 2018/1100, which broadens the scope of the European Blocking Statute to include the U.S. sanctions against Iran lifted as a result of the Vienna Agreement, as well as any action based on or arising from those sanctions.

The effectiveness of the European Blocking Statute rests on the ability of Member States to enact national legislation prohibiting any violation of the European Blocking Statute and ensuring against the continuation of any violations. However, only a few Member States have adopted national legislation to this end *(e.g.*, the United Kingdom considers this violation to be a criminal offence). As a result, since its entry into force, the European Blocking Statute tends to be considered ineffective due to its lack of application. European companies faced with the choice between complying with U.S. secondary sanctions and violating the European Blocking Statute, tend to choose the former because of the aggressive prosecution policy pursued by OFAC, the high fines resulting therefrom for European companies violating the U.S. sanctions provisions and finally, because of the possibility of finding themselves on the SDN List. European companies therefore prefer to run the risk of violating the European Blocking Statute (and incur relatively minor sanctions), by withdrawing from the Iranian market rather than face the consequences of being designated an SDN under the secondary sanctions (*i.e.*, exclusion from the US financial system and the ban on dealing with U.S. persons, which is likely to jeopardize the survival of many companies).

4. Cases pending before the ECJ

On March 2, 2020, in the case between the German branch of Bank Melli Iran and Telekom Deutschland,[5] the Hanseatic Higher Regional Court made a request to the ECJ for a preliminary ruling. In accordance with the Treaty on the Functioning of the European Union (the "TFEU"), proceedings before the Higher Regional Court must be suspended and a request for a preliminary ruling referred to the ECJ before a judgment is handed down with respect to Bank Melli's appeal.[6] The ECJ's interpretation of Article 5 of the European Blocking Statute is therefore a prerequisite for resolving the dispute.

Bank Melli argues that the purported termination of its agreements with its German counterparty has no effect because it violates Article 5 (1) of Regulation (EC) No 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 applies to, *inter alia*, "*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 on the amendment of the European Blocking Statute,[7] European entities (such as Telekom Deutschland) do not have to comply with designated extraterritorial laws and regulations or any subsequent decision based on them, to the extent that the EU does not recognize their effects.

Accordingly, the Hanseatic Higher Regional Court has raised four questions which will enable the German court to determine whether the termination by Telekom Deutschland violates Article 5 (1) of the European Blocking Statute and whether the latter is effective.

5. Questions for the ECJ on the implementation of Article 5 of the European Blocking Statute

- **1. Does Article 5(1) of Regulation No 2271/96 apply only if the United States addresses, directly or indirectly, instructions from the administrative or judicial authorities to an economic operator in the European Union within the meaning of Article 11 of such Regulation, or is it sufficient for that article to apply that the action by the economic operator is intended, even in the absence of such instructions, to comply with secondary sanctions?**

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

For the time being, the Hanseatic Higher Regional Court considers that the mere existence of secondary sanctions is sufficient for Article 5 (1) to apply. Accordingly, for the German court, Telekom Deutschland did not need to invoke an official or court decision in support of its notice of termination in order for the European Blocking Statute to apply.

It is to be hoped that the ECJ does not consider an official or court decision in the United States to be a prerequisite for application of the European Blocking Statute. Such a position would effectively considerably hamper the effectiveness of the European Blocking Statute by significantly reducing its scope.

- **2. Assuming that the Court responds to the first question in the way suggested by the second subsidiary argument: does Article 5(1), of Regulation No. 2271/96 preclude an interpretation of national law to the effect that the person who gives notice of termination may terminate any contractual relationship of a lasting nature with a contractual partner included by the United States Office of Foreign Assets Control (OFAC) in the list of Specially Designated Nationals (SDN), and therefore does the Court have to state termination on the grounds of wishing to comply with United States sanctions, without there being any need for a reason for termination, and therefore without having to state and demonstrate in civil proceedings that the reason for termination would not, in any case, be the wish to comply with United States' sanctions?**

In other words, is Telekom Deutschland violating the European Blocking Statute by giving notice of termination without declaring that it is based on compliance with U.S. sanctions?

According to the Commission's Policy Paper of August 7, 2018, European entities 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. As a result, several German courts consider that a European operator can exercise its right to terminate contracts at any time without justification. In our case, this would mean that Telekom Deutschland was free to give notice to Bank Melli for commercial or financial reasons at any time without having to provide an explanation.

The Hanseatic Higher Regional Court considers that a termination strictly based on compliance with U.S. sanctions would indeed violate Article 5 of the European Blocking Statute. It adds that termination on grounds unrelated to the sanctions would be lawful. Therefore, in the event of uncertainty as to the grounds for termination, Telekom Deutschland should explain the reason for its termination in order to avoid any doubt as to a possible violation of the European Blocking Statute.

This interpretation of Article 5 would be consistent with the purpose of the European Blocking Statute and would prevent its misuse by foreign entities to challenge a termination notice based on purely commercial or financial grounds. The purpose of the European Blocking Statute is to protect European entities from the negative consequences of the extraterritorial reach of U.S. secondary sanctions and not to serve as a weapon for foreign entities to challenge lawful terminations based on purely commercial grounds.

- **3. Should the Court provide a positive response to the second question: Is an ordinary termination in violation of Article 5(1) of Regulation No. 2271/96 necessarily to be regarded as ineffective, or can the purpose of the regulation also be served by other sanctions such as the imposition of a fine?**

In other words, is a termination that violates the provisions of the European Blocking Statute automatically considered ineffective or would damages suffice to meet the objectives of the European Blocking Statute.

Article 9 of the European Blocking Statute provides 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*." German civil law provides that the termination of a contract for breach of Article 5 (1) of the European Blocking Statute is ineffective. Under German law, such a violation constitutes an administrative offence punishable by a fine of up to 500,000 Euros.

The Hanseatic Higher Regional Court adopted a pragmatic approach in considering that, in view of the economic losses to which Telekom Deutschland is exposed in the event of exclusion from the U.S. market, it could be considered disproportionate to prevent it from terminating its contractual relationship with Bank Melli rather than simply imposing a fine.

We agree with the interpretation of the German court, even if it seems unlikely that the ECJ would take a position on the nature of the sanction to be imposed in the event of a violation of the European Blocking Statute, insofar as the latter would thereby encroach on the prerogatives of the Member States.

This raises the broader question of the divergence of national measures adopted by Member States in the event of a violation of the European Blocking Statute. It would therefore be helpful if the EU, in particular through its RELEX guidelines, could clarify the nature of the sanctions recommended in the event of violation of the European Blocking Statute, although this is likely to encroach on the competence of Member States in criminal matters. Without such guidance, the principal criticisms of the European Blocking Statute, namely its lack of implementation by Member States, are likely to continue and differences in interpretation between Member States will increase.

- **4. Assuming that the Court responds to the third question in the way suggested by the first subsidiary argument: Is this so in light of Articles 16 and 52 of the Charter of Fundamental Rights of the European Union, on the one hand, and the possibility of granting derogations under Article 5 (2) of Regulation No 2271/96, on the other hand, even where the European Union economic operator may risk, by continuing the commercial relationship with the listed contractual partner, suffering significant economic losses on the U.S. market (in this case 50% of the group's turnover)?**

In other words, if termination of the contracts is considered ineffective because it is contrary to the European Blocking Statute, would this not defeat the objective of this law (which is to protect European entities) if maintenance of the contractual relationship with Bank Melli (to comply with the European Blocking Statute) exposes Telekom Deutschland to significant economic losses?

As stated above, the European Blocking Statute is a shield to protect European entities and is not intended to protect foreign companies such as Bank Melli. This case illustrates the dilemma faced by European entities when they have significant operations both in the United States and in a country subject to secondary U.S. sanctions. Effectively, they are caught between the hammer (compliance with U.S. secondary sanctions by terminating their contractual relationships with sanctioned companies to avoid being designated as SDN themselves), and the anvil (compliance with the provisions of the European Blocking Statute by maintaining their contractual relationships with these designated persons).

The German regional court added that if the European operator decided to comply with EU law and therefore maintain its relationship with the Iranian bank, the considerable economic loss it would suffer as a result of designation as an SDN would not be compensated by the recovery claim provided for in Article 6 of the European Blocking Statute. Accordingly, the mere deterrent effect of the U.S. secondary sanctions for companies with significant turnover or a significant presence in the United States outweighs the potential financial compensation granted under Article 6 of the European Blocking Statute. This further weakens the European Blocking Statute.

In addition, the European Blocking Statute offers European entities faced with such a dilemma the option of applying for an authorized exemption allowing them to comply with U.S. regulations. However, it can be assumed that any issuance of such exemptions that would render the European Blocking Statute meaningless is strictly limited. Therefore, mere imminent economic loss might not be deemed a sufficient reason for an exemption.

The Hanseatic Superior Regional Court also highlighted the inherent conflict between the risk of substantial economic loss resulting from a violation of U.S. secondary sanctions and the freedom of enterprise, protected by Article 16 of the Charter of Fundamental Rights of the European Union and the principle of proportionality enshrined in Article 52 of the Charter.

This last issue raises several interesting problems and highlights the sometimes inextricable situation in which European entities find themselves, caught between (i) compliance with directly applicable EU law (whose sanctions in the event of violation are not significant from an economic point of view), and (ii) the negative consequences of designation as an SDN for violating U.S. secondary sanctions and the corresponding economic losses. Therefore, it is expected that the EU or the ECJ itself will provide clear and pragmatic guidance taking into account the economic context in which European entities facing similar situations find themselves.

6. Conclusion

The ECJ's ruling on interpretation of Article 5 (1) of the European Blocking Statute may have significant influence on the future management of European companies. It is effectively the first time that the EU Court has been invited to give its general understanding and opinion on implementation of the European Blocking Statute.

This ruling illustrates the dilemma faced by European entities when they have significant turnover or activities in the United States or simply when they deal in U.S. Dollars and also maintain commercial relations with countries subject to secondary U.S. sanctions. This dilemma is not theoretical and has, as this case illustrates, strong commercial implications and consequences, particularly with regard to the fate of existing contracts with entities designated as SDNs. European entities should not be left to their own devices without specific guidelines enabling them to apprehend these complex risks.

This case would appear to highlight the main shortcomings of the European Blocking Statute, namely its lack of effectiveness and differences between EU Member States on the adoption, content and application of national legislation sanctioning violations of the European Blocking Statute. Efficitively, in the absence of a unified and clear framework at the EU level, the current situation risks leading to "forum shopping" between Member States: some countries offer more protection than others against the negative consequences of U.S. secondary sanctions.

The ECJ has a rare opportunity here to clarify its position and offer a unified approach, as well as provide pragmatic and long-awaited guidance to European entities. Expectations on this point are very high and this referral is a real opportunity for the ECJ to finally respond.

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

[2] Article 5 (1) of Regulation (EC) No. 2271/96 provides as follows: "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 U.S. Sanctions Regulation defines a U.S. Person as: any entity organized under the law of the United States and its foreign subsidiaries and branches; any U.S. subsidiaries and branches of a foreign company; any U.S. citizen (including dual nationals) or permanent resident (Green Card holder), wherever located; and any person, who is physically present in the U.S. territory, regardless of nationality, for the duration of his or her stay, any non-U.S. director, corporate officer or employee while in the United States.

[4] Free translation of Article 1(a)(iii) of Executive Order 13846.

[5] Case no. C-124/20.

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

[7] Commission, Guidance Note, Questions and Answers: adoption of update of the Blocking Statute of August 7, 2018.

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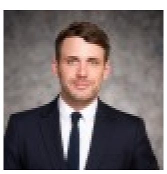

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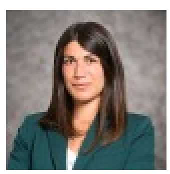

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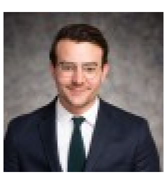

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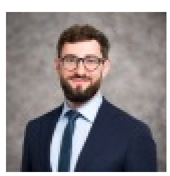

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