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European Union Amends Blocking Regulation in Effort to Counter Implementation of Certain U.S.-Iran Sanctions

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International Trade Controls

As described in our May 9, 2018, alert, the United States determined on May 8, 2018, to end its participation in the Joint Comprehensive Plan of Action ("JCPOA") and re-impose sanctions against Iran that had been suspended as part of this 2015 nuclear agreement between the United States, Iran, Germany, France, the UK, and China.

On May 18, 2018, the European Commission announced that it would amend the terms of the EU Blocking Regulation (European Council Regulation No. 2271/96) to prohibit EU companies from complying with U.S. sanctions that will be re-imposed following the U.S. President's decision on May 8, 2018.[1] On June 6, 2018, the European Commission adopted those amendments,[2] which update the Regulation to include certain of the sanctions that the United States will re-impose in relation to Iran, together with certain aspects of the U.S. sanctions that had been in place even under the JCPOA framework.

The contemplated revisions do not enter into force immediately. Instead, the European Parliament and the Council will have a two-month period to object to the measures adopted by the European Commission. If no objection is raised, the amended Blocking Regulation will come into force on **August 6, 2018** (or sooner if the Parliament and Council confirm that they have no objections prior to that date), coinciding with the end of the 90-day wind down period for certain aspects of the re-introduced U.S. sanctions.

This alert provides an overview of the amendments to the EU Blocking Regulation.

Background

In the mid-1990s, the United States undertook a series of steps to expand its sanctions relating to Iran, Libya, and Cuba. Those sanctions included, among other measures, the passage of the U.S. Iran and Libya Sanctions Act ("ILSA"), which for the first time introduced "secondary" sanctions that allowed the U.S. executive branch to impose retaliatory measures against parties who engaged in certain business and investment activities in Iran (and originally Libya, although

[1] *See http://europa.eu/rapid/press-release_IP-18-3861_en.htm.*
[2] *See http://europa.eu/rapid/press-release_MEX-18-4085_en.htm.*

the Libya aspects of the ILSA were subsequently removed). Those measures are referred to as "secondary" sanctions because the U.S. government can impose them on non-U.S. parties without the need to demonstrate a nexus between the non-U.S. party's sanctioned country activities and U.S. persons, U.S.-regulated items, or U.S. territorial jurisdiction.

In response to the ILSA and other U.S. sanctions measures, the European Union issued the Blocking Regulation in 1996. Ultimately, however, the Blocking Regulation has never been significantly implemented or enforced, and it had not been amended—until the amendments published last week—in the years since its passage, despite significant changes in the last 22 years to the U.S. secondary sanctions. Indeed, some EU Member States have never even issued implementing regulations to allow for penalties or establish reporting procedures under the Blocking Regulation.

The virtual dormancy of the Blocking Regulation has largely been a function of U.S.-EU policy trends. In the early years following the passage of the ILSA, the Clinton Administration agreed to waive application of the ILSA for an Iran project involving European companies, following objections from the EU to the extra-territorial application of the U.S. secondary sanctions and agreement by EU authorities to cooperate with the United States on various sanctions. Moreover, from 2005 to 2012, the EU and U.S. policies on Iran became more closely aligned. The EU introduced its own sanctions program against Iran in that period, and the U.S. expanded its secondary sanctions program relating to Iran, without objection from the EU.

Those combined U.S. and EU sanctions measures ultimately had a significant impact on Iran's ability to engage in international trade and other business dealings, which contributed to Iran's willingness to negotiate and agree to the JCPOA. The U.S. departure from the JCPOA once again places the U.S. and EU positions on Iran at odds, and invites new questions as to the potential imposition of secondary sanctions against European companies that do business with Iran, and the European Union's appetite to use the Blocking Regulation as a tool to counter those U.S. sanctions.

Overview of the EU Blocking Regulation

The Blocking Regulation prohibits compliance with, imposes reporting requirements in relation to, and establishes a private right action for losses arising from certain discrete aspects of the U.S. sanctions laws and regulations. The key provisions of the Blocking Regulation are summarized herein.

U.S. Sanctions Within the Scope of the Blocking Regulation

The requirements and prohibitions of the Blocking Regulation extend to certain specific U.S. sanctions programs, which are listed in the Annex to the Regulation. Before last week's amendments, those U.S. sanctions included only aspects of the U.S.-Cuba sanctions, and the original ILSA sanctions focused on investments in Iran (and Libya, under the original ILSA) that exceed USD 40 million that directly and significantly contribute to Iran's ability to develop petroleum resources. The Annex to the Blocking Regulation had not previously been amended since the original passage of the Regulation in 1996.

The amendments adopted last week by the Commission revise the Annex to include a range of U.S. sanctions relating to Iran, including aspects of both the U.S. primary and secondary sanctions. (The provisions of the Annex relating to Cuba remain unchanged, and the

Commission did not expand the Annex to cover secondary sanctions programs focused on other countries, such as the U.S. sanctions relating to Russia and Crimea.) As amended by the Commission, the Annex specifically references aspects of the U.S. *secondary* sanctions relating to:

- transactions concerning the Iranian petroleum, petroleum products, natural gas, and petrochemicals sectors;
- transactions involving certain persons in the ports, energy, shipping, or shipbuilding sectors in Iran, or any Iranian person included in the U.S. Specially Designated Nationals and Blocked Persons List;
- transactions involving significant goods or services used in connection with the Iranian energy, shipping, or shipbuilding sectors;
- trade with Iran in precious metals, graphite, raw/semi-finished metals, and certain software products;
- transactions involving certain specified underwriting and insurance/re-insurance services;
- significant financial transactions involving certain Iranian financial institutions;
- transactions involving the issuance of Iranian sovereign debt; and
- transactions that facilitate the provision of specialized financial messaging services to designated Iranian financial institutions.

The Annex also makes reference to certain aspects of the U.S. *primary* sanctions. It describes, in particular, aspects of the U.S. Iranian Transactions and Sanctions Regulations ("ITSR") that prohibit the re-export to Iran of goods, technology, or services that have been exported from the United States or that are otherwise "subject to export control rules in the USA" (which presumably is intended to include non-U.S. items that contain greater than *de minimis* levels of U.S.-controlled content). It is notable that those ITSR sanctions were not suspended or eased under the JCPOA itself, and they have been in place for many years, pre-dating the original 1996 Blocking Regulation. Hence, the Commission's amendments, in this regard, would seem to extend to U.S. sanctions that were unaffected by the JCPOA, and that the EU did not deem necessary to include in the Blocking Regulation when it was originally implemented in 1996.

It is also notable that while the Blocking Regulation refers to the ITSR re-export controls, it does not refer to separate, and largely parallel, Iran re-export controls set forth in the U.S. Export Administration Regulations ("EAR").

The Blocking Regulation's Annex also references provisions in the Iran Threat Reduction and Syria Human Rights Act of 2012 ("ITRSHRA") that extended the reach of the U.S.-Iran primary sanctions to the conduct of non-U.S. companies that are owned or controlled by U.S. persons. While the Blocking Regulation does not provide a specific citation, we assume that the reference relates to Section 218 of the ITRSHRA, which extends liability to *U.S. parent companies* to the extent those companies' subsidiaries knowingly engage in transactions with Iran that would be prohibited if undertaken by a U.S. person or in the United States. The Blocking Regulation Annex notes, however, that the ITRSHRA requirement at issue "applies to foreign subsidiaries owned or controlled by U.S. persons," thus raising questions as to exactly how the Blocking Regulation could be used in relation to this specific ITRSHRA provision.

Requirements and Prohibitions of the Blocking Regulation

Persons subject to the jurisdiction of the Blocking Regulation are required, pursuant to Article 2 of the Regulation, to affirmatively inform the Commission within 30 days of obtaining "information" that their economic and/or financial interests are directly or indirectly affected by the sanctions listed in the Annex. The process by which those reports must be filed remains unclear—the Commission has not issued guidance on this point, nor have most EU Member States. As a matter of practice, we are not aware of many EU companies that have affirmatively issued reports under Article 2 in the past, despite the ostensible application of the legacy ILSA sanctions and U.S.-Cuba sanctions to the business activities of some EU companies.

Separately, Article 5 of the Blocking Regulation prohibits EU parties from "comply[ing]" with any requirement or prohibition of sanctions listed in the Annex. That prohibition extends to any act, "including requests of foreign courts, based on or resulting, directly or indirectly from" the sanctions programs in question. Article 5 also authorizes the EU authorities to grant licenses to permit compliance with the U.S. sanctions, where failure to comply would result in serious damage to the interests of an EU person or the European Community.

Finally, Article 6 of the Blocking Regulation provides that EU persons "shall be entitled to recover any damages, including legal costs, caused to that person by the application of the laws specified in the Annex or by actions based thereon or resulting therefrom," and that 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 or intermediary[.]" It is not clear whether that provision seeks to authorize litigation or other proceedings in EU courts against U.S. government authorities or against corporate affiliates of affected EU parties.

While the European Commission retains a number of key administrative roles under the Blocking Regulation—including in connection with the licensing process set forth in Article 5—enforcement of the Regulation is delegated to the individual Member States. Article 11 of the Regulation provides that sanctions for breaches of the Regulation must be "effective, proportional and dissuasive[.]"

Potential Implications of the Amended Blocking Regulation

Ultimately, if the EU and its Member States are serious about re-invigorating the Blocking Regulation, a number of immediate questions become apparent. Those include the following, among other considerations:

- How will the EU Member States implement the Blocking Regulation, and will those implementation efforts be coordinated and consistent among the Member States?
- Will the EU Member States use the Blocking Regulation primarily as a tool to obtain concessions from the U.S. government to refrain from imposing penalties or sanctions on EU companies? Conversely, will the EU Member States be inclined to impose penalties against EU companies that take action to avoid transactions that would present a serious risk of triggering U.S. sanctions?
- Will the Commission and EU Member States be willing to grant licenses under Article 5, in circumstances where EU companies face a significant threat of the imposition of U.S. sanctions against them?

- What will regulators' expectations be concerning the facts that would trigger reporting under Article 2 of the Regulation? What will the process be for filing those reports, and when will the reports become due?
- What types of conduct could be construed as "complying" with the U.S. secondary sanctions within the meaning of Article 5, given the nature of the U.S. secondary sanctions as a retaliatory trade regime rather than a set of rules that trigger civil or criminal penalties in the event of breaches?
- How broadly will the private right of action in Article 6 apply, and will EU courts be willing to apply Article 6 liberally in circumstances where an EU party suffers losses, or lost business opportunities, as a consequence of the U.S. secondary sanctions? Moreover, what parties are the intended targets of such actions?

It should be noted that on June 4, 2018, the EU, UK, France, and Germany wrote a joint letter to the U.S. Secretaries of State and Treasury seeking certain exemptions from U.S. secondary sanctions for EU persons in various sectors that have initiated dealings in and with Iran. It is unclear how that request has been received by the U.S. government, but any outcome from that outreach by the EU authorities may influence the ultimate use of the amended Blocking Regulation.

We will continue to monitor developments in this area from the European Union and United States in the coming months. If you have any questions concerning the material discussed in this client alert, please contact the following members of our International Trade Controls practice:

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