Bank Melli Opinion: The EU Blocking Regulation Grows Teeth

May 18, 2021

On 12 May 2021, Advocate General Hogan issued his opinion (the "Opinion")[1] in *Bank Melli Iran v Telekom Deutschland GmbH*,[2] the first case by the Court of Justice of the European Union ("CJEU") considering the EU Blocking Regulation.[3] The Opinion is not legally binding, but because Advocate General's recommendations are followed by the CJEU in the majority of cases, the Opinion offers insight into CJEU's likely approach.

The EU Blocking Regulation has caused concern for businesses because it prohibits compliance by EU persons with certain U.S. sanctions on Iran and Cuba, but significant questions remained as to its scope and interpretation. If the Opinion is adopted by the CJEU, as is likely to be the case, it would add to the challenges for companies attempting to juggle compliance with U.S. sanctions and EU law. Companies may have to reconsider how they deal with matters that potentially implicate the EU Blocking Regulation, and how they justify taking action that may be construed as unlawful compliance with U.S. sanctions.

THE EU BLOCKING REGULATION

The EU Blocking Regulation was introduced in 1996 as a means of protecting EU persons against the perceived extraterritorial effects of certain U.S. sanctions, initially those against Cuba and, since 2018, those against Iran. If an EU person takes action to comply with relevant U.S. sanctions, it is at risk of breaching the Regulation—which, in some EU Member States, can lead to criminal penalties. However, if the EU person fails to comply with U.S. sanctions, it could risk violating primary U.S. sanctions (if it is a subsidiary of a U.S. company, for example) or becoming a target of U.S. secondary sanctions.

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1 ECLI:EU:C:2021:386.

2 Case C-124/20.

3 Council Regulation (EC) No 2271/96 of 22 November 1996 (the "EU Blocking Regulation" or the "Regulation"), as amended by Commission Delegated Regulation (EU) 2018/1100 of 6 June 2018.

The relative dearth of enforcement or judicial interpretation of the EU Blocking Regulation has resulted in ambiguities as to its scope and application. When EU Member State courts have considered the Regulation, their rulings sometimes have been inconsistent. For example, the Higher Regional Court in Cologne, Germany has held that the EU Blocking Regulation only applied if a contract with a U.S.-sanctioned person was terminated following an order from the U.S. authorities requiring such termination.[4] In contrast, Dutch and Italian courts applied the EU Blocking Regulation to a broader range of circumstances.[5]

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Against this backdrop, the Opinion provides some clarity on the interpretation of the EU Blocking Regulation, though likely not in a way that would be welcomed by EU businesses caught between U.S. sanctions and the Regulation.

In this case, the German branch of Bank Melli Iran (the "Bank") entered into a framework contract with Telekom Deutschland GmbH ("Telekom") for the provision of telecommunication services. Under German law, the contract could be terminated at any time, after a statutory notice period, without reason. The Bank was sanctioned by the United States on 5 November 2018, pursuant to a sanctions regime covered by the EU Blocking Regulation. Eleven days later, Telekom terminated its contracts with the Bank's German branch.

The Bank sued, asking the court to order Telekom to continue providing contractually agreed services. The German court of first instance held that Telekom's contract termination was valid and did not violate the EU Blocking Regulation. The Bank appealed to the Hanseatic Higher Regional Court in Hamburg, which stayed the proceedings pending referral of four questions to the CJEU.[6] On 12 May 2021, Advocate General Hogan published his Opinion, setting out his proposed answers to these questions.

Question 1: Scope of activities covered by the EU Blocking Regulation

The Opinion noted that the wording of the EU Blocking Regulation forbids compliance with any "*requirement*" in the listed U.S. sanctions laws. As such, the Advocate General found that the EU Blocking Regulation applies to any action taken to comply with any of those U.S. laws, "*even in the absence of instructions or requests by an administrative or*

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4 *Oberlandesgericht Köln*, February 7, 2020, Az. 19 U 118/19.

5 *See*, for example, *PAM International NV v Exact Software Nederland BV* NL:RBDHA:2019:6301 (District Court (The Hague), 25 June 2019).

6 *Hanseatisches Oberlandesgericht Hamburg*, request for preliminary ruling March 2, 2020, 11 U 116/19.

judicial body."[7] In other words, if an EU person terminates a contract because the counterparty was sanctioned under one of the relevant U.S. laws, it may be in violation of the EU Blocking Regulation even if the U.S. authorities did not order the company to terminate the contract.

Unfortunately, the Opinion does not address what actions, other than termination of a contractual relationship with a U.S.-sanctioned entity, could constitute improper compliance with U.S. sanctions laws. This is an issue on which European courts have taken differing views.[8] In absence of further guidance, the courts are likely to continue to define "*compliance*" on the basis of specific facts of each case.

Question 2: Rationale for contract termination

The Advocate General confirmed that the EU Blocking Regulation provides a private cause of action to third parties, including U.S.-sanctioned persons who may seek to use the Regulation to undo contract termination. This interpretation of the EU Blocking Regulation aligns with the prior consensus among sanctions practitioners.

The Opinion then considered whether an EU person must proactively provide a counterparty with reasons for terminating a contractual relationship where termination without cause is legally permissible, but the counterparty is subject to U.S. sanctions. The Advocate General noted that while the text of the EU Blocking Regulation does not impose such a requirement, the EU person must provide reasons for termination once there is a dispute with the counterparty in order to give effect to the Regulation's aims. Otherwise, according to the Opinion's reasoning, the counterparty would have no ability to prove that the contract termination was taken in breach of the EU Blocking Regulation.

The Advocate General emphasised that the EU Blocking Regulation does not force EU persons to deal with any particular counterparties, including those sanctioned by the United States, provided the EU person can demonstrate that its refusal to deal with the counterparty was genuinely for reasons other than the relevant U.S. sanctions. The Opinion listed a number of reasons why EU persons may not wish to transact with Iranian counterparties, including concerns over Iran's "*nuclear ambitions*", its "*willingness to finance and support… terrorist groups*", "*its discriminatory treatment of women and minorities*" and "*its promiscuous use of the death penalty*".[9] But these reasons would have to form part of a "*coherent and systematic corporate social-responsibility*

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7 Paragraph 54 of the Opinion.

8 For example, see *Mamancochet Mining Limited v. Aegis Managing Agency Limited and Others* [2018] EWHC 2643 (Comm), which contrasts to the approach taken in other judgements discussed in this article, such as *PAM International NV v Exact Software Nederland BV*.

9 *See* paragraph 87 of the Opinion.

policy" to avoid an inference that actions were taken in breach of the EU Blocking Regulation.

The Opinion places particular emphasis on the need for companies not only to give reasons for terminating relationships where EU Blocking Regulation may be implicated, but also justifying those reasons. The Advocate General did not opine on the burden of proof that courts should apply when establishing whether an EU person has "*proved*" that its decision was based on valid reasons other than relevant U.S. sanctions. That question is likely to be left to the courts of EU Member States, which is likely to result in divergence in the levels of deference or scrutiny given to an EU person's rationale.

Question 3 & 4: Consequences of breaching the EU Blocking Regulation

Although the EU Blocking Regulation allows EU Member States to decide on penalties for breaching the Regulation, the Opinion noted that this discretion is limited by Member States' obligation to ensure that the penalty adequately addresses the public policy underpinning the Regulation. In the Advocate General's view, a payment of damages would not be sufficient because it would allow EU persons to continue complying with U.S. sanctions upon paying the damages.

Consequently, the Advocate General opined that the EU Blocking Regulation obliges courts to require specific performance of contracts terminated in breach of the EU Blocking Regulation. The Opinion noted the difficulties that this outcome would present for EU companies, given the significant potential penalties from the U.S. authorities. Nevertheless, the Advocate General considered that specific performance is necessary to give effect to the Regulation's public policy considerations.

On this question and throughout his Opinion, the Advocate General acknowledged the difficulties his interpretation of the EU Blocking Regulation presents for EU companies. He stated that it gave him "*no particular pleasure to arrive at this particular result*", which places companies in "*an unenviable and almost impossible position*". In his view, however, these conclusions were unavoidable given the "*very blunt*" wording of the EU Blocking Regulation. Therefore, the Opinion called on the EU to consider amending the Regulation.[10]

IMPACT ON EU BUSINESSES

The Opinion confirms the view that EU persons can terminate business relationships with persons subject to U.S. sanctions, provided that the decision to do so is clearly and

[10] Paragraph 136 of the Opinion.

demonstrably based on reasons other than compliance with U.S. sanctions laws listed in the EU Blocking Regulation. Such reasons could include genuine commercial, anti-bribery and corruption, and corporate social responsibility considerations. If the Opinion is adopted by the CJEU, it is likely that such non-U.S. sanctions reasons will be subject to greater scrutiny. Where a contract termination could be construed as taken for reasons prohibited by the EU Blocking Regulation, it is critical for the companies to adduce evidence of other valid rationale for the termination to mitigate legal risks in the EU.

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