The Evolution of the EU Blocking Regulation: CJEU on *Bank Melli*

5 January 2022

On 21 December 2021, the Court of Justice of the European Union (the "CJEU") issued a Decision[1] (the "Decision") in *Bank Melli Iran v Telekom Deutschland GmbH*, its first case considering the EU Blocking Regulation.[2] The EU Blocking Regulation has caused concern for EU businesses as it prohibits compliance by EU persons with certain U.S. sanctions on Iran and Cuba, but significant questions had remained as to its scope and interpretation.

The Decision generally follows the advice of Advocate General Hogan's May 2021 opinion (the "Opinion"),[3] subject to one welcome twist: In contrast to the Opinion, the CJEU decided that EU Member State courts are not obliged to order a party in breach of the Regulation to continue performing contracts with parties targeted by U.S. sanctions if the impact on the breaching party would be disproportionate. While the Decision may soften the Regulation's effect on EU businesses, its impact may be short-lived given the European Commission's intention to amend the Regulation later this year.

The EU Blocking Regulation

The EU Blocking Regulation was introduced in 1996 as a means of protecting EU persons against the 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 risks breaching the Regulation, resulting in administrative fines and, in some EU Member States, criminal penalties. On the flipside, if an EU person fails to comply with U.S. sanctions on Iran or Cuba, it risks violating primary U.S. sanctions (if it is a EU subsidiary of a U.S. company, for example) or becoming a target of U.S. secondary sanctions (which can be applied to an entity operating anywhere in the world).

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1 ECLI:EU:C:2021:1035, case C‑124/20.

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

3 ECLI:EU:C:2021:386. Read our client update on the Opinion here.

The European Commission can authorise compliance with U.S. sanctions if there is evidence that non-compliance would cause serious damage, but such authorisations are rarely sought given the uncertainty of the process. Further, the dearth of enforcement or judicial interpretation of the Regulation has rendered its scope and application ambiguous, presenting further compliance challenges.

Bank Melli Iran v Telekom Deutschland

Against this backdrop, the *Bank Melli* case provides some clarity on the scope of the EU Blocking Regulation and available remedies for breaches. 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 and 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 without giving a reason.

The Bank sued, asking the German civil court to declare the termination invalid and 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 Higher Regional Court Hamburg, which stayed the proceedings pending the reference of four questions to the CJEU for a preliminary ruling.[4] The CJEU answered the questions as follows:

Question 1: Scope of the Activities Covered by the Regulation

The EU Blocking Regulation forbids compliance with any "*requirement or prohibition*" in the listed U.S. sanctions laws. German case law suggested that the Regulation was triggered only if compliance with U.S. sanctions was specifically ordered by a U.S. authority. The CJEU, however, agreed with the Advocate General that the Regulation covers any action taken to comply with relevant U.S. sanctions laws, including "*act[s] of a general and abstract nature […] even in the absence of an order directing compliance issued by the administrative or judicial authorities of the third countries which adopted those laws.*"[5] In other words, an EU person complying with U.S. sanctions on Iran or Cuba may be in violation of the Regulation even if U.S. authorities did not specifically order it to comply.

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

5 Paragraphs 46 & 51 of the Decision.

Question 2: Rationale for Contract Termination

The Decision confirms that the EU Blocking Regulation provides a private cause of action to third parties, including U.S.-sanctioned persons. They may seek to use the Regulation to undo actions allegedly taken in violation of the Regulation, including contract termination. This interpretation of the Regulation aligns with case law and the consensus among sanctions practitioners.

The CJEU also considered whether an EU person must proactively provide a counterparty with reasons for terminating a contractual relationship if termination without cause is legally permissible, but the counterparty is subject to U.S. sanctions. The Decision confirmed that the EU Blocking Regulation does not create such blanket requirement, with one important caveat. The CJEU ruled that, if the claimant in a civil litigation establishes a *prima facie* case of a breach of the Regulation, the burden of proof is on the defendant to establish that its action was not taken to comply with relevant U.S. sanctions. The CJEU reasoned that shifting the burden of proof in this way is necessary to give effect to the Regulation, given the evidentiary difficulties that the claimant would otherwise have in establishing the defendant's intent.

Questions 3 & 4: Consequences of Breaching the Regulation

Although the EU Blocking Regulation allows EU Member States to decide on penalties for breaching the Regulation, the CJEU held that this discretion is limited by Member States' obligation to ensure that the penalty adequately addresses the public policy underpinning the Regulation, while respecting general principles of EU law, including proportionality.[6]

The CJEU appeared to acknowledge that a remedy of specific performance would best protect the public policy underpinning the Regulation. Nevertheless, the CJEU held that Member State courts do not have to impose specific performance if its impact would be disproportionate, such as causing extensive economic losses to an EU person. The Decision directs Member State courts to balance the defendant's interest in complying with U.S. sanctions against the EU public policy underpinning the Regulation and to determine if a remedy other than specific performance would be appropriate.

The Decision contrasts with the Advocate General's Opinion, which proposed that specific performance was the only appropriate remedy despite the difficulties it may create for EU persons. It remains to be seen, however, how the Member State courts apply the Decision. The CJEU stated that Member State courts should consider whether the EU person had sought to limit its losses by applying for an authorisation from the

[6] Paragraph 70-73 of the Decision.

European Commission.[7] If the courts view application for authorisation as a precondition for ordering a remedy other than specific performance, the latter may become the sole penalty *de facto*, given that the authorization process is rarely used in practice.

The Unanswered Questions

The Decision provides some clarity on the scope and application of the EU Blocking Regulation, but it leaves several key questions unanswered.

- **Meaning of "Compliance" with U.S. Sanctions**: The Decision does not clarify what actions, other than contract termination, can constitute "compliance" with U.S. sanctions. The CJEU used broad language when discussing the concept of compliance but did not explicitly consider what actions would qualify. For example, it remains uncertain whether merely agreeing to (but not acting upon) a contractual term stating that a party will comply with U.S. sanctions could be a breach of the Regulation. The Decision also does not contain any practical guidance on circumstances in which an EU person may elect not to do business with Iranian and Cuban counterparties for reasons other than compliance with U.S. sanctions.[8]

- **Scope of U.S. Sanctions Caught by the Regulation**: The CJEU did not have to consider the position of EU subsidiaries of U.S. companies, which are required to comply with certain U.S. primary sanctions. There has been some debate among practitioners as to whether the wording of the EU Blocking Regulation is intended to be limited to compliance with U.S. secondary sanctions. The Decision focused on secondary sanctions, given that Telekom is not a subsidiary of a U.S. company, and did not consider whether the situation would be different otherwise.

- **Alternative Remedies for Breaching the Regulation**: The Decision is silent on what remedies other than specific performance can be imposed. Presumably those would be damages, but lack of guidance from the CJEU may result in stark differences in their amounts and other inconsistencies in how the Regulation is enforced across the EU.

- **Impact on the UK Blocking Regulation**: The UK has retained the EU Blocking Regulation, meaning it continues to form part of UK law post-Brexit. Given that the UK is no longer part of the EU, the CJEU's Decision is not binding on the UK, and it

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7 Paragraph 93 of the Decision.

8 The Advocate General's Opinion, in contrast, gave examples of corporate social responsibility-related reasons for why an EU person may legitimately decide not to transact with Iran. *See* paragraph 136 of the Opinion.

could adopt a different interpretation of the Regulation.[9] So far, the UK government has been silent on how it will interpret the Regulation, although in practice its approach appears to be closely aligned to that of the EU.

Proposed Reform of the EU Blocking Regulation

The CJEU's Decision is reflective of a wider EU trend to strengthen the Union against the extraterritorial impact of third country laws.

In January 2021, the European Commission announced its proposal to amend the EU Blocking Regulation to better achieve its intended purpose. During the initial public consultation, the Commission received overwhelmingly negative feedback on the current operation of the Regulation.[10] Respondents agreed that the extraterritorial impact of U.S. sanctions laws has a significant negative impact on the EU and its businesses (a finding echoed in the Commission's recent report on the Regulation),[11] but said that the Regulation has been unsuccessful in protecting against that negative impact. In particular, respondents criticised the lack of awareness of the existence of the Regulation in the EU, lack of clarity on its scope and application, lack of enforcement, and insufficient and inconsistent penalties for breaches. The EU Commission is expected to publish an amended version of the EU Blocking Regulation in Q2 2022.

In December 2021, the European Commission adopted a legislative proposal containing measures to protect the EU and its Member States from "*economic coercion from third countries*."[12] The so-called Anti-Coercion Instrument would empower the Commission to implement a range of trade and investment restrictions, such as blocking access to EU markets and EU-funded research programmes, against third countries that interfere in the EU or Member State policy decisions. It is unclear how the Anti-Coercion Instrument will interact with the EU Blocking Regulation, but there are calls for close alignment between the two given the overlap in subject matter.

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9 *See* Sections 3 & 6 of the European Union (Withdrawal) Act 2018.

10 Summary of results of the open public consultation on the review of the Blocking Statute, Ref. Ares(2021)7829130.

11 Report from the Commission to the European Parliament and the Council relating to Article 7(a) of Council Regulation (EC) No 2271/96, COM(2021) 535 final.

12 Proposal for a Regulation on the European Parliament and of the Council on the protection of the Union and its Member States from economic coercion by third countries, 2021/0406 (COD).

Impact for Businesses

In the meantime, EU businesses should continue to consider whether actions they take can be viewed as motivated by compliance with U.S. sanctions against Iran and Cuba. If a conflict between the EU Blocking Regulation and U.S. sanctions is difficult to avoid, the Decision means that EU businesses might not be forced to breach U.S. sanctions (which could result in very significant monetary and non-monetary penalties), but rather face other consequences, such as damages in the relevant EU Member State. However, it remains to be seen how Member States' courts will perform this proportionality assessment in practice.

The Decision is unlikely to prompt EU Member States to take a more proactive stance towards enforcing the Regulation. In that respect, given the very limited public enforcement of the EU Blocking Regulation, EU businesses' main risks are likely to continue to arise from civil complaints brought by Iran or Cuba-linked counterparties.

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