



BARRIERS TO SANCTIONS: EU TAKES ACTION TO PROTECT TRADE WITH IRAN

In a joint announcement on 18 May 2018, Donald Tusk, the head of the European Council and Jean-Claude Juncker, President of the European Commission, declared the EU's intention to counteract American President Trump's withdrawal from the Joint Comprehensive Plan of Action ("JCPOA") and to protect European companies from the extraterritorial reach of America's reimposition of secondary sanctions on Iran.

Europe's response consists of measures intended to act on four separate fronts and thereby secure the interests of European countries and companies in Iran to achieve the objectives of the Nine Point Economic Plan announced by the EU earlier in the week.

These targeted measures include:

- Launching a formal process to extend the EU blocking statute to cover the new U.S. measures,
- Exploring avenues to further strengthen intra-sector cooperation between EU and Iranian entities,
- Paving the way for an alternative means of financing through the European Investment Bank ("EIB"),
- Encouraging Member States to adopt one-off bank transfers to the Central Bank of Iran ("CBI") in order to further facilitate their oil-related transactions.

WHAT DOES THIS MEAN IN PRACTICE? EVALUATING THE IMPLICATIONS OF THE EUROPEAN COMMISSION'S STRATEGY

When he revealed his four-pronged strategy at the leaders' summit held in Sofia, Bulgaria, on 16-17 May 2018, Jean-Claude Juncker declared that the EU must shield European entities from the effects of the pending reintroduction of primary and secondary sanctions on Iran, as announced by the American President on 8 May and enacted through his National Security Presidential Memorandum ("NSPM").

While emphasizing Europe's commitment to maintaining trade and diplomatic relations with the United States, President Juncker has made clear, through the proposals described below, that the European Commission is making an all-out effort to safeguard European political and economic relations with Iran.

Amending the EU Blocking Statute to cover U.S. sanctions on Iran

Originally crafted in 1996 in response to U.S. sanctions against Cuba, EU Regulation 2271/96 aims to protect and counteract the effects of U.S. extraterritorial sanctions affecting European individuals and companies. By updating the list of sanctions covered by the scope of the EU blocking regulation to include Iran-related U.S. sanctions, the European Commission has played a strong hand to reassure EU companies and signal the illegitimacy of America's actions.

As the preamble of the blocking statute rightly recalls, “by their extra-territorial application, such laws, regulations and other legislative instruments violate international law and impede the attainment of [international trade].”

In effect, the blocking measures listed by the EU regulation are designed to be legally protective and dissuasive: that is, this statute is meant to protect European companies so that they do not feel compelled to abide by American sanctions, and may, moreover, serve to boost European countries' political leverage in any future negotiations with the Trump administration. To understand how these measures can serve such ends, it is important to appreciate the precise methods by which the blocking regulation actually functions.

First and foremost, it creates an obligation for European companies to advise the European Commission should their economic and/or financial interests be affected by extraterritorial laws, whether directly or indirectly.

It also bans the recognition and execution of any court judgment or decision of an administrative authority giving effect to American sanction laws. In addition, no person shall cooperate actively, or by deliberate omission, accede to foreign requests based on these extraterritorial laws (although there is a possibility to obtain an EU exemption to do so). In this way, the blocking regulation functions as a true counter to (and mirror of) OFAC regulations. While OFAC regulations seek to dissuade persons from engaging in Iranian business through the threat of sanctions, the blocking regulation seeks to dissuade EU persons from obeying extraterritorial laws and disrupting their business with Iran through the threat of legal action and civil penalties.

Finally, the regulation empowers companies and entities engaged in activities with Iran to recover damages arising from any claims related to financial harm incurred as a result of the American extraterritorial regulations and claims brought by an American entity (presumably in this case the U.S. Treasury) against such a European one. To do so, a company has the ability to sue under European jurisdiction and seek “seizure and sale” of European-based assets of the U.S. entity, including the U.S. Government, which has brought a claim against them.

It is to be noted that violations of the EU blocking regulation are punishable under national laws such that each Member State is allowed to determine the penalty it deems appropriate so long as such penalties remain “effective, proportional and dissuasive.” It is furthermore automatic under EU law, in order to guarantee full effect to these blocking measures, that each and every Member State must implement such legislation.

For example, according to German law, breaches of the blocking regulation may constitute an administrative offence under article 82, paragraph 3 of the German Foreign Trade Ordinance (*Außenwirtschaftsverordnung*) and can be punished by a fine of up to 500,000 euros. By contrast, some other countries such as Belgium and France have not yet enacted such enforcement legislation, presumably because they did not expect this to be necessary. However, this lacuna can quickly be filled.

Uniformity of implementation of these statutes will, in any event, be the result of the legal character of the EU “blocking statute”. The European Commission has confirmed that it is taking steps to implement fully the blocking statute before 6 August 2018 when the U.S. measures will apply under the NSPM.

Thus, the aim of EU action is to amend and formally extend the scope of the statute’s annex to include the reimposed U.S. sanctions on Iran, thereby effectively implementing the EU’s commitment to uphold the terms of the JCPOA through the protection and support of its companies’ relations with Iran.

Bolstering EU investment in Iran through the European Investment Bank

The European Commission has also taken steps to launch a formal process to enable the European Investment Bank to expand its scope to cover the financing of European company investments in Iran, effectively paving the way for financial guarantees via a public institution. Such an avenue for financing may serve as a particularly useful, no-risk financing vehicle for small and medium-sized companies (“SMEs”) seeking to transmit short or long-term capital to Iran.

Fending off the extraterritorial effects of U.S. sanctions laws may entail the creation of more such alternative financing channels for banks and companies, which are necessary to fulfill the objective of securing European interests in Iran in the medium and long-term. More generally, the European ambition to offer these financial mechanisms may eventually serve to undermine the international hegemony of the U.S. currency and lead, over time, to a reduction in the exposure of European banks to the American financial system.

Among the options proffered to reduce dependence on the dollar would be the creation of an EU clearing house, functioning only in euros, allowing European banks’ financial flows and operations to bypass the dollar and thus avoid falling under American jurisdiction. While this is an ambitious project, beyond the reimposition of sanctions against Iran, these concerns are a welcome inroad to diversifying the global payments system away from the U.S. dollar. Such a project may have broader implications and far reaching consequences than merely reducing the potency of OFAC sanctions on Iran, or Russia.

Protecting small and medium-sized European businesses in Iran

In a bid to build confidence between the EU and Iran, the President of the European Commission has also called for the Commission to continue to strengthen the EU-Iranian intrasector cooperation (e.g. hydrocarbons, transportation, renewables, agriculture, medicine, consumer products) and redouble assistance to it. This measure has been drawn up expressly with small- and medium-sized enterprises in mind, including those engaged in the energy sector. Unlike much larger companies which often have diversified business interests both in Europe and across the Atlantic, and may believe that an OFAC exemption is necessary to remain in Iran, SMEs can, if properly incentivized, continue to engage in dynamic cross-border trade with Iran, constituting an important symbolical and therefore political contribution to the maintenance of the Nuclear Deal.

Facilitating one-off transfers between EU entities and the Central Bank of Iran

With a particular commitment to maintaining the flow of oil-related transactions, and financial transfers between Iranian and EU entities, the European Commission has proposed that Member States should explore alternative means (e.g. inter alia, outside of SWIFT, payment in kind, or payable-through accounts networks) of facilitating transactions between parties

through “one-off” transfers to the Central Bank of Iran in order to assist repatriation to Iran of such revenues derived from the sales of crude oil and petroleum products.

Under the aegis of Miguel Arias Canete, European Commissioner for Energy, who visited Tehran on 19 May 2018 to present plans for maintaining Europe's purchases of Iranian hydrocarbons, Europe has reaffirmed its commitment to, and requirement for, the 500.000+ barrels of Iranian oil it purchases every day. This commitment also extends to guaranteeing direct euro-denominated payments and establishing credit lines for Iran's oil exports. By design, such facilities would directly contravene America's stated intent to reinstate the harsh measures of the 2012 National Defense Authorization Act, which threatened America's allies with the menace of significant sanctions if they did not demonstrate substantial reductions in their purchases of Iranian crude oil. It remains to be seen to what extent these measures can offset the risk perceived by global hydrocarbons trading firms and integrated oil companies whose first inclination may be to cling to the United States and its dollar and shun Iran, owing to their close ties to the American financial system.

TIMELINE REMINDER

To better understand the sequence of these events, the dates and circumstances provided below are intended to recapitulate, in summary format, the key moments starting with, and coming in the wake of, the reintroduction of U.S. sanctions.

8 May 2018: President Trump announces the United States' withdrawal from the Joint Comprehensive Plan of Action and plans for the return of all sanctions previously imposed and lifted or waived as a result of the Nuclear Agreement. Such sanctions are due to come into effect following overlapping “wind-down” periods, the first of which concludes on 6 August 2018 and the second of which finishes on 4 November 2018, after which, presumably, all prior sanctions are to be reinstated in full force.

9 May 2018: European Union High Representative, Federica Mogherini, issues a Declaration reaffirming Europe's commitment to the continued implementation of the JCPOA so long as Iran upholds its end of the bargain.

14 May 2018: Iran opens [talks](#) for the creation of a special German-based bank to facilitate transactions with Europe, which would also involve Russia. The concept demonstrates solidarity between EU, Iranian and Russian interests in the face of American political caprice and the persistent threat of extraterritorial sanctions which may hurt not only Russian and Iranian economic interests but European ones as well.

15 May 2018: European and Iranian Ministers convene to formulate a diplomatic solution. European and Iranian press report the introduction of a [Nine-Point Plan](#) to save the JCPOA and talks of an interbank facility to support Euro-Iranian transactions are floated.

16 May 2018: The President of the European Commission Jean-Claude Juncker and High Representative Federica Mogherini, convene with European leaders in Sofia, Bulgaria, and receive unanimous backing for their proposals to preserve the Nuclear Agreement.

18 May 2018: The European Commission acts to protect the interests of EU companies investing in Iran by launching the procedures necessary to apply a mechanism to activate the EU blocking statute, and also to secure funding and strengthening financial ties between Iran and Europe for small- and medium-sized companies under the auspices of the European Investment Bank. The plan explores the possibility of novel types of financial transfers to the Central Bank of Iran with a particular focus on assisting EU entities engaged in Iranian energy transactions.

EUROPEAN BLUEPRINT AND BUSINESS EXPECTATIONS

While the details of the roadmap remain unclear, the destination is firmly in sight: the European Commission's and the Council's joint announcement signals the EU's continued support for the tenets of the JCPOA and its intention to implement to the best of its ability Europe's commitments under that pact. The tightrope that Europe is currently treading in its effort to balance American and Iranian relations and to satisfy a diverse set of political interests means that all proposals in respect of this renewed Iranian initiative will be discussed over the next weeks in order to define something acceptable to most Member States.

The Commission is in the driver's seat. Once its formal proposal has been made, Member States will be called upon to express themselves. Only a qualified majority in the Council may undo the Commission's proposal, in whole or in part.

Europe, as a whole, seems intent on keeping the Nuclear Agreement alive. However, taking action which could provoke further unforeseeable actions by President Trump clearly worry some EU leaders, starting with Mrs. Merkel, but other members of the German government are on the same line as France, i.e. to reject and counteract U.S. sanctions. France will continue to play a pivotal role, advocating, as it always does, a strong EU stance. It is the very sovereignty of the EU itself and its trade bloc integrity which is being questioned by American extraterritoriality.

For better or worse, European banks, despite not utilizing the U.S. dollar for any meaningful portion of their continental affairs, tend to be well-integrated into in the global dollar-based payment network for international business. They will be intent on obtaining strong EU protection against U.S. dollar related sanctions as major financial interests will be at stake.

A continuation of this strong stance by the EU will, of course be conditional upon Iran's maintenance of the status quo (insofar as its compliance with the terms of the JCPOA is concerned). The next several weeks will see much intense diplomatic activity with Europe, and especially France, trying to find an acceptable compromise to all, Iran and the U.S.

Additional avenues for the EU could also include putting pressure on the U.S. to review the extraterritorial nature of its sanctions or to obtain specific derogations for companies. As way of example, in 1996, the threat of a WTO complaint led to the adoption by the U.S. of a sanctions waiver for certain situations, and allowed companies to avoid active enforcement. Should a WTO complaint be initiated, although U.S. sanctions are clearly intended to qualify as security measures, their extraterritorial effect may be viewed as violating Article XXI GATT and the principle of good faith, which should guide the application of this provision. This was in fact mentioned in the European Commission's [press release](#) dated 18 May.

Further client alerts pursuant to such developments will follow.

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