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IRAN: THE FIRST PACKAGE OF U.S. EXTRATERRITORIAL SANCTIONS AND THE UPDATE OF THE EU BLOCKING STATUTE

❖ US extraterritorial sanctions are back into force by August 7, 2018

The first of the so called '*wind down period*' stated by the US administration has expired on Monday, August 6, 2018. These wind down periods were established as a result of Trump's pulling out from the Joint Comprehensive Plan Of Action, the 'Iran nuclear deal', on May the 8th this year. The original sanctions, which were suspended by effect of the JCPOA, will as consequence revive on August 7, 2018. The new Executive Order "*Reimposing certain Sanctions With Respect to Iran*", also called "the New Iran E.O.", restores the sanctions which were lifted by the E.O. 13176 of January 16, 2016 and brings to an end the *wind-down general licenses* (GLs). Notably, as asserted by the FAQ 1.2 *Frequently Asked Questions Regarding the Re-Imposition of Sanctions Pursuant to the May 8, 2018 National Security Presidential Memorandum Relating to the Joint Comprehensive Plan of Action (JCPOA)* and by the FAQs 598, 601 e 606, which form part of the additional FAQs "*Regarding Executive Order of August 6, 2018, "Reimposing Certain Sanctions With Respect to Iran*", published simultaneously with the new Executive Order, sanctions are restored and extended for the following activities:

- sanctions on the purchase or acquisition of US dollar banknotes by the Iranian government, of US Dollars;
- sanctions on Iran's trade in gold and precious metals;
- sanctions on the direct or indirect sale, supply or transfer from or to Iran of graphite, raw metals or semi-finished products, such as aluminium and steel, coal and software for integrating industrial processes;
- sanctions on "*significant*" transactions related to the purchase or sale of Iranian Rials, or the deposit of funds or the maintenance of significant bank accounts outside the territory of Iran in Iranian Rials currency;
- sanctions on the purchase, subscription to, or facilitation of the issuance of sovereign Iranian debt;
- sanctions on Iran's automotive sector;
- sanctions for diverting goods intended for the Iranian population, including food, medical and agricultural products, if they are used for facilitating censorship or human rights abuses.

All of the above-mentioned sanctions bear some extraterritorial profiles. They apply to non-US companies and they apply in absence of a lien between the mentioned activities and the US jurisdiction (i.e. by the subjects involved, commodity traded or method of payment).

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On November 5, 2018 a second block of US sanctions will be reinstated. These will particularly hit the port operators, and shipping and shipbuilding sectors, petroleum-related transactions and energy sector. The SDN List will grow by a number of Iranian physical and juridical persons, naming among these almost all of the Iranian banks (the so called "13599").

❖The European Union's reply: the updated Blocking Statute, the Implementing Regulation and the Commission's FAQs

The EU reaffirmed its intention to maintain the JCPOA, clearly opposing the new US position. In particular, the EU considers the extraterritorial effects of US sanctions as a violation of International Law.

The EU published the following documents on September 7, 2018, which have been waited for by business operators in order to understand how to combine the simultaneous application of the Extraterritorial US rules and the EU Blocking Regulation:

• Commission Delegated Regulation (EU) 2018/1100 of 6 June 2018 amending the Annex to Council Regulation (EC) No 2271/96 "protecting against the effects of extra-territorial application of legislation adopted by a third country, and actions based thereon or resulting therefrom", modifying the Annex to the Regulation (EC) n. 2271/96 of the European Council ('Blocking Regulation'). The Regulation lists the US Extraterritorial Rules which are considered unlawful by the EU, in order to protect the European operators. On August 7, the new Annex becomes legally binding;

• Commission Implementing Regulation (EU) 2018/1101 of 3 August 2018 laying down the criteria for the application of the second paragraph of Article 5 of Council Regulation (EC) No 2271/96, thus authorising the EU operators to comply in all or in part to the Extraterritorial Sanctions.

• Frequent Questions (FAQs) on Blocking Regulation and Implementing Regulation.

At the end of July 2018, after 22 years, the EU finally defined the procedural rules of the Extra-Territorial Legislation Committee as per the article 8 of the Blocking Regulations; the mentioned Rules replicate the standard EU comitology procedures.

The EU also published a standard Template for applications for authorisations under Article 5 paragraph 2 of Council Regulation (EC) No 2271/96 (for a resume of the newly introduced rues, please see: http://ec.europa.eu/dgs/fpi/what-we-do/blocking_statute_en.htm).

❖ Our Opinion

The Blocking Regulation was introduced 22 years ago to cancel, neutralize, block and anyway avoid the extraterritorial effect that could affect some European trading operators. It was adopted to protect against restrictive measures imposed by the USA against Cuba, Libya and Iran. In order to keep up to date the Extraterritorial List of US Rules, which cannot be lawfully executed in the EU, and in order to take into account the evolution of US rules along the years, also in light of Trump's declaration dated May 8, 2018, the EU has now chosen to substitute the whole **Annex to the Blocking Regulation.**

As we anticipated in our clients' alert last June 2018, the wording of the Annex to the Regulation is subject to some technical remarks: i.e. it is unclear if the automotive extraterritorial sanctions and those sanctions applying to certain blacklisted entities are actually embedded in the definitions of the new Annex.

The Blocking Regulation – which was applied for by our Firm in the event of the 2014 sanctions imposed by the US State Department's against Dettin S.p.A. in relation to activities which were wholly and perfectly lawful according to the National and UE regulations – provides for **penalties against any European entity which, in absence of a previous authorization by the European Commission, would give execution to extraterritorial US sanctions (article 5)**. Furthermore, it prescribes the right to **recover any damages, including legal costs, caused by the application of the extraterritorial laws specified in the Annex or by actions based thereon or resulting therefrom** (Article 6). In Italy, the administrative sanction is that of the Legislative Decree n. 346 of 1998, with a maximum cap of 92.962,00 Euros.

The combined provisions of Article 5 and 6, in fact, provide that if a European company intends to pull out from a contract with European counterparts for supplies in Iran or, in absence of an agreement with the counterparts, modifies the contract terms and conditions **on the basis of the sole US Regulations without any authorizations from the European Commission**, the company might face a civil action for damages plus the administrative sanction. In Italy, this sanction is imposed by the Ministry for Economic Development (MISE). Therefore, it is advisable to take prudent care in continuing contractual relations with Iranian counterparts that are subject to US sanctions, or in suspending or terminating them.

Pursuant to Article 2 of the Blocking Regulation, whenever the economic and/or financial interests of an European operator are affected, directly or indirectly, by the measures listed in the Annex to the Blocking Regulation, or by actions based thereon or derived therefrom, the operator shall **inform the European Commission within thirty days from the event**, directly or through the Member States competent authorities.

Subparagraph 2 of Article 5 allows the European Commission to **authorise the European operators to comply, fully or in part, with the US extraterritorial sanctions**, to the extent that non-compliance would seriously damage their interests or those of the Community.

It is clarified in the FAQs that such authorization is only agreed by way of waiver to the general rule and only in specific and duly motivated circumstances. The request has no suspensive effects. The authorization, granted by an implementing decision, becomes effective by the date of notification to the applicant. Until then, the EU operators are compelled to apply the Blocking Regulation.

Pursuant to Article 3 of the Implementing Regulation of the Commission (EU) n. 2018/1101, applications for an authorization as per Article 5, Subsection 2, of the Regulation (EC) n. 2271/1996 shall be in writing and shall include the name and contact details of the applicants, shall indicate the precise provisions of the listed extra-territorial legislation or the subsequent action at stake, and shall describe the scope of the authorisation that is being requested and the damage that would be caused by non-compliance. In their application, the applicants shall also provide sufficient evidence that non-compliance would cause serious damage to at least one protected interest.

Where necessary, the Commission may request additional evidence from the applicants, which shall provide it within a reasonable period set by the Commission. The Commission shall inform the Committee on Extra-territorial Legislation as soon as it receives applications.

It is important to highlight that the Implementing Regulation (EU) n. 2018/1101 establishes the criteria to be considered by the Commission to decide on the seriousness of the damage (for the operators and the EU) in relation to non-compliance with US extraterritorial rules. The non-cumulative criteria include, by way of example:

- the existence of an ongoing administrative or judicial investigation against the applicant from, or a prior settlement agreement with, the third country which is at the origin of the listed extra-territorial legislation;
- the existence of a substantial connecting link with the third country which is at the origin of the listed extraterritorial legislation or the subsequent actions; for example the applicant has parent companies or subsidiaries, or participation of natural or legal persons subject to the primary jurisdiction of the third country which is at the origin of the listed extra-territorial legislation or the subsequent actions;
- whether measures could be reasonably taken by the applicant to avoid or mitigate the damage;
- the adverse effect on the conduct of economic activity, in particular whether the applicant would face significant economic losses, which could for example threaten its viability or pose a serious risk of bankruptcy;
- whether the applicant's activity would be rendered excessively difficult due to a loss of essential inputs or resources, which cannot be reasonably replaced;
- whether there is a threat to safety, security, the protection of human life and health and the protection of the environment;
- the consequences for the internal market in terms of free movement of goods, persons, services and capital, as well as financial and economic stability or key Union infrastructures;
- the systemic implications of the damage, in particular as regards its spill over effects into other sectors.

Notably, the Commission's FAQs, which are just an interpretative guideline and not a legal act, dwell about the controlled/subsidiaries of American companies in the EU territory and, vice-versa, about the European subsidiaries in US Territory, distinguishing three situations:

When EU subsidiaries of U.S. companies are formed in accordance with the law of a Member State and have their registered office, central administration or principal place of business within the Union, they are considered EU operators. This implies that they enjoy all the rights and are subject to all the obligations under Union law, including the Blocking Statute.

Branches of U.S. companies in the Union do not fall under the previous paragraph as they do not have distinct legal personality from their parent company. They are not considered EU operators. Therefore, they are not subject to the Blocking Statute.

Subsidiaries of EU companies in the U.S. are subject to the law under which they are incorporated, which is generally that of the U.S. Therefore, they are not considered to be EU operators and are not subject to the Blocking Statue. Nevertheless, their parent company incorporated in the Union is an EU operator and, as such, it is subject to the provisions of the Blocking Statute.

We believe that the regulation and guidelines are not adequate in relation to the complexity of the subject issue. This can include, for example, situations involving European subsidiaries of US entities in light of a revocation of the *General License H*. These entities are affected by the US Primary Legislation (including monetary sanctions applicable to the *U.S. Persons*). Therefore, they will face a particularly harsh dilemma in choosing which regulation to comply with. It is likely that these companies will have to apply for an authorization by means of article 5, to comply with the US Primary sanctions by which they are affected. Should you need our help, we would be mostly pleased to help solving this issue.

On the other hand, subsidiaries of European companies in US territory are not considered European operators and cannot be granted the Blocking Regulation shield, which instead covers the mother company in the EU. This scenario might lead to a paralysis in the relations between the European mother company and the subsidiary in the US territory.

The FAQs also deal with the issue of the request by a European Operator of a US license derogating the extraterritorial sanctions. The Commission considers such request as an acceptance of the US extraterritorial regulation and therefore illicit.

On the contrary, EU operators will be allowed to request to the European Commission an authorization to be able to apply for a US license, pursuant to Article 5, second Subparagraph, of the Blocking Regulation. Should you also need help for this matter, we would be mostly pleased to offer our services.

Collective authorizations of compliance with the US Law can also be requested to the European Commission. We expect that representative bodies of companies and banks or insurances will take such actions, in order to settle the position of some of their participating members.

It is worth mentioning the so-called ***Sanction Clauses***, frequently found in international financial agreements: they are affected by the Blocking Regulation whenever the underlying contracts are based on the Law of a Member State (anyhow, the parties' nationality could not be relevant, due to the fact that the behaviour requested by the Sanction Clause could be illicit on the basis of the Blocking Regulation). We would be therefore pleased to analyse the contractual clauses of the operators to identify the most suitable strategy.

The EU legislative update blocking the US extraterritorial rules might create some undeniable difficulties for the European operators on the Iranian market, due to the necessary coordination between conflicting Laws.

Our firm has contributed to the preparatory work of the package of rules adopted by the European Union and is the only one in Europe to have gained experience in using the Blocking Regulation in the last 5 years. We are available to assist in handling the new rules and, where appropriate, to support those involved in the preparation of the applications for authorization referred to in the second paragraph of Article 5 of Regulation (EC) No. 2271/1996.

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