STUDIO LEGALE
PADOVAN

Client Alert
Export Control
June 2018

THE EUROPEAN COMMISSION PLAYS THE BLOCKING REGULATION CARD TO COUNTER U.S. SANCTIONS AGAINST IRAN

The EU issued yesterday a draft of the Commission delegated Regulation of June 6th 2018 to amend the Annex to Council Regulation (EC) No 2271/96 of 22nd November 1996. The new draft provides a list of U.S. laws which the EU consider illegitimate to the extent of their extraterritorial jurisdiction on European companies. This is a pivotal EU initiative in response to Donald Trump's announcement of the U.S. withdrawal from the Joint Comprehensive Plan of Action ("JCPOA") on May the 8th, 2018.

The withdrawal from the JCPOA implies the re-enforcement of the so-called 'secondary sanctions' - *i.e.* those applicable to European companies and credit institutions even in the absence of any relationship between the EU company and the U.S. – which had been suspended pursuant to the JCPOA.

The draft Regulation has been approved by the Commission following the procedure set forth in Article 11a of Regulation No. 2271/1996, thus the European Parliament and the Council must express any possible objections within two months: in the absence, the Regulation shall enter into force. As a consequence, there is no certainty on when it will take effect, although we understand the objective of the EC is to have it in force on or before August 7, 2018, when the United States will reimpose the first set of extraterritorial sanctions (i.e. restrictions related to the trade of graphite, raw or semi-finished materials and those linked to the automotive sector). We will keep you up to date with further developments.

1. The "blocking Regulation" in short

The EC Regulation No. 2271/96 (otherwise known as "blocking Regulation") provides for sanctions against individuals and entities who implement – without the prior authorization of the European Commission – the extraterritorial effects of the U.S.; furthermore, pursuant to the blocking Regulation, European companies which have been damaged by the extraterritorial effects of U.S. legislation are entitled to recover the related damages. Our law firm is the only one in Italy which actually called for the application of the blocking Regulation in the well-known "Dettin case" of 2014. This experience, unfortunately, showed the shortcomings of the act we are now reviewing.

For more details, contact:


Avv. Marco Padovan
mpadovan@studiopadovan.com


Avv. Marco Zinzani
mzinzani@studiopadovan.com


Avv. Valerio Picchiassi
vpicchiassi@studiopadovan.com


Avv. Ilaria Anna Colussi
icolussi@studiopadovan.com


Dott.ssa Giulia Levi
glevi@studiopadovan.com


Dott. Manuel Venuti
mvenuti@studiopadovan.com

2. The draft of new Annex to Regulation (EC) No. 2271/96

The blocking Regulation has been adopted twenty-two years ago in order to counter the extraterritorial effects of certain sanctions adopted by United States against Cuba, Iran and Libya.
As consequence of the lack of power to amend the Regulation and shortage of time to launch the legislative procedure of the Union, the Commission has only amended it by adding certain U.S. provisions concerning Iran and having extraterritorial effects.

From the entry into force of the delegated Regulation the following provisions will therefore be considered unlawful and subject to the EU block:

i. Iran Sanctions Act of 1996. This piece of U.S. legislation was already mentioned in the Regulation adopted on 1996 and it is repeated, in its most updated version, in the current draft Annex. Pursuant to this law, sanctions are imposed against any subject which (i) invest in Iran at least USD 20 million during a period of 12 months that directly and significantly contributes to the enhancement of the Iranian ability to develop their petroleum resources; (ii) provide to Iran goods, services or other types of support any of which is worth USD 1 million or more, or of aggregate value of USD 5 million or more over a period of 12 months, that could directly and significantly facilitate the maintenance or expansion of Iran's domestic production of refined petroleum products or its ability to develop petroleum resources located in Iran; (iii) provide to Iran goods, services or other types of support any of which is worth at least USD 250,000 or more, or of aggregate value of USD 1 million or more over a period of 12 months, that could directly and significantly contribute to the maintenance or expansion of Iran's domestic production of petrochemical products; (iv) provide to Iran (a) refined petroleum products or (b) goods, services or other types of support which could directly and significantly contribute to the enhancement of Iran's ability to import refined petroleum products, any of which is worth USD 1 million or more, or of aggregate value of USD 5 million or more over a period of 12 months; (v) participate in a joint venture for the development of petroleum resources outside of Iran established on or after 1 January 2002 and in which Iran or its Government has particular interests; (vi) be involved in the transport of crude oil from Iran or conceal the Iranian origin of cargo consisting in crude oil and refined petroleum products;

ii. Iran Freedom and Counter-Proliferation Act of 2012, providing for extraterritorial sanctions against any subject which gives significant support to Iran - including the facilitation of significant financial transactions or the purchase/supply of goods and services – in the sectors of energy, maritime services, shipping, shipbuilding, petroleum, petroleum products, natural gas, precious metals, graphite, raw or semi-finished metals, insurance (we will further tackle the aforementioned tasks);

iii. the National Defense Authorization Act for fiscal year 2012, providing for the prohibition of carrying out significant financial transactions (or of facilitating them) with the Central Bank of Iran or another designated Iranian financial institution;

iv. Iran Threat Reduction and Syria Human Rights Act of 2012 which prohibits the facilitation of the issuance of Iranian sovereign debt and the engagement in any transaction directly or indirectly with the Government of Iran as well as the provision of specialized financial messaging services to (or the facilitation to direct or indirect access to such messaging services) for the Central Bank of Iran or a financial institution whose interests in property are blocked in connection to Iran's proliferation activities;

v. the reference to the Iranian Transactions and Sanctions Regulations appears where it is provided for the prohibition of re-exporting goods, technologies and services that (a) have been exported from the USA and (b) are subject to export control rules in the USA, if the export is made knowing or having reason to know that it is specifically intended for Iran or its Government. The Annex specifies that this prohibition does not apply to "goods substantially transformed into a foreign-made product outside the USA, and goods incorporated into such a product and representing less than 10% of its value are not subject to the prohibition".

3. Some comments

3.1 Automotive: the "missing" sector?

it must be outlined that the automotive sector is not listed among the "protected" sectors, even though OFAC – in its FAQs of May 8, 2018 – has clearly stated that, as of May 7, 2018, United States will reimpose secondary sanctions in this sector. In particular, Executive Order No. 13645 will be reinstated. It provides for sanctions on the sale, supply or transfer to Iran of "significant" goods or services which may contribute to (i) Iran's ability to research, develop, manufacture, and assemble light and heavy vehicles, and (ii) the manufacturing or assembling of original equipment and after-market parts used in Iran's automotive industry.

It is worth taking into careful consideration the high exposure of European companies operating in the automotive sector in Iran.

3.2 The "software that may be used in specific sectors or involve certain persons"

As anticipated above, the Commission has transposed the U.S. legislative provision of "software for integrating industrial process" - mentioned by OFAC in its FAQs of May 8 and indicated in the Iran Freedom and Counterproliferation Act of 2012 – in a softer and more limited "software that may be used in specific sectors or involve certain persons". We are not aware of the grounds on the basis of which the act has been drafted. However the difference between the two texts may additionally jeopardize the implementation of the act.

For this purpose, it must be noted that neither the U.S. laws, nor the regulations on economic sanctions nor OFAC provide for a definition of "software for integrating industrial process". This could lead to an extensive interpretation of the term.

3.3 The reference to U.S. export control rules

It is worth noting the addition of the reference to the Export Control rules of the U.S. in the Annex, which have a general extraterritorial reach, and not only when Iran is concerned.

One might legitimately wonder what happens should the U.S. sanction a European entity for having exported a U.S. controlled item (or an item incorporating more than the *de minimis* U.S. controlled content) without the B.I.S. license to a third country outside Iran. We assume this situation is not covered by the Blocking Regulation without any logic reason for this disparity.

Furthermore, it helps reminding that the reference to U.S. export control rules may lead the EU to reconsider the international cooperation - and implemented to date – established between European forces and BIS inspection staff.

4. Administrative penalties imposed by Italy for the infringement of the blocking Regulation

In Italy sanctions for breaching Regulation No. 2271/96 are set forth in Legislative Decree No. 346/1998. In particular, the decree provides for:

- administrative fine up to EUR 46.481,00 for breach of the duty of information to the European Commission as per Article 2 of the blocking Regulation;

- administrative fine up to EUR 92.962,00 for giving effect, without the prior authorization of the European Commission, to obligations (including claims, prohibitions and requests from foreign courts) deriving from U.S. extraterritorial measures.

5. Conclusions

In spite of its declared purpose of sheltering European companies from the damages deriving from the extraterritorial effects of U.S. legislation (effects that the European Union has always considered - at least formally – contrary to international law), the blocking Regulation needs radical reform to achieve its goal.

The application of the Regulation in the European Union has been invoked very scarcely in the past and once by our law firm in the "Dettin case", with limited results. Indeed, in the absence of

a serious mechanism to restore the damages and to react to the extraterritorial enforcement of U.S. legislation, it leaves EU companies and credit institutions confronted with the hard choice between compliance to mandatory rules such as those imposed upon European individuals and entities by the blocking Regulation and management of the risk of being affected by the harsh U.S. sanctions.

For time reasons, the European Commission has decided not to amend the main body of the Regulation, although such an amendment has been invoked by many parties. As said, the Regulation could have provided for more dissuasive sanctions to be adopted at the EU level (not at the national one) or could have provided for the creation of a European fund to compensate the damages caused by the extraterritorial effects of U.S. legislation. The Commission should have accepted to play a more active role in managing the crisis deriving from the imposition of the extraterritorial U.S. sanctions, instead of leaving this task to the member States as it has happened in the past. These inconsistencies and shortcomings of the blocking Regulation were well clear to the operators on “Dettin case”.

The effectiveness of the amended act will largely depend on Member States, companies and credit institutions will to have the European legislation prevail over the U.S. extraterritorial one. In this perspective we cannot ignore the fact that the misalignment between U.S. and EU legislation we witnessed in the last months (e.g. the CAATSA legislation adopted in August, the Power Machines and Mahan Air cases as well as the listing of many Russian oligarchs in April) is certainly not encouraging.

It is of the utmost importance that, given the above described legal and political framework, European companies and credit institutions take informed strategic decisions. Should you need any further assistance, our very experienced team will be most pleased to help you.