



U.S. Sanctions and the E.U. Blocking Regulation: Issues of Legal Uncertainty

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1. EXECUTIVE SUMMARY AND INTRODUCTION

- 1.1. The role of the Financial Markets Law Committee (the “**FMLC**” or the “**Committee**”) is to identify issues of legal uncertainty or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks and to consider how such issues should be addressed.
- 1.2. On 8 May 2018, the United States announced its withdrawal from the Joint Comprehensive Plan of Action (the “**JCPOA**”) and the re-introduction of its nuclear-related economic sanctions on Iran that had been previously lifted as part of the JCPOA, subject to 90- and 180-day wind-down periods. On 5 November 2018, following the expiry of the two wind-down periods, the United States fully re-imposed the sanctions on Iran that had been lifted or waived under the JCPOA, and also extended the scope of certain of these sanctions.
- 1.3. On 18 May 2018, the European Commission announced its intention to expand Regulation (EC) No 2271/96 protecting against the effects of the extra-territorial application of legislation adopted by a Third Country, and actions based thereon or resulting therefrom (the “**Blocking Regulation**”)—which, *inter alia*, prohibits E.U. persons from complying with specified extra-territorial sanctions—to cover the re-imposed U.S. measures on Iran.² On 6 June 2018, the European Commission adopted the Commission Delegated Regulation (EU) 2018/1100 (the “**Delegated Regulation**”) to update the annex to the Blocking Regulation (the “**Annex**”) to include certain U.S. measures on Iran.³ The Delegated Regulation came in force on 6 August 2018, the date when the first of the two U.S. wind-down periods expired.
- 1.4. This paper examines the issues of legal uncertainty which arise under English law as a result of the amendment to the Blocking Regulation to cover certain re-imposed U.S. sanctions on Iran. In keeping with the FMLC’s role, this paper only examines the relevant issues of legal uncertainty with a focus on the financial markets, and does not engage in any commentary regarding wider implications of U.S. sanctions or the Blocking Regulation. Any discussion of the background to the U.S. sanctions and the

² European Commission - Press release: *European Commission acts to protect the interests of EU companies investing in Iran as part of the EU’s continued commitment to the Joint Comprehensive Plan of Action*, available online: http://europa.eu/rapid/press-release_IP-18-3861_en.htm.

³ 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, available online: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.LL.2018.199.01.0001.01.ENG>.

Blocking Regulation is included only for the purposes of providing context to the legal framework.

- 1.5. The Blocking Regulation is not a “new” legal issue as it has been in place for many years, but the broad nature of the re-imposed U.S. sanctions and their extra-territorial application has raised some new issues and increased the prominence of existing issues of legal uncertainty which this paper seeks to address. This paper seeks to give recommendations or views on the issues of legal uncertainty where possible, but recognises that uncertainty cannot be avoided entirely where there are two legal regimes with conflicting objectives. This paper therefore seeks to illustrate particular areas of risk that the FMLC has identified as a result of these uncertainties.
- 1.6. Section 2 of this paper sets out the background to the legal framework to the Blocking Regulation, including the manner in which it is implemented in the U.K. Section 3 considers the issues of legal uncertainty arising under English law as a result of the extension of the Blocking Regulation. In particular, Section 3 addresses issues of legal uncertainty arising under the Blocking Regulation with respect to (i) definitional analyses, (ii) its applicability to private counterparties, (iii) its jurisdictional scope, (iv) the authorisation procedure, (v) the ability to bring certain damages claims under the Blocking Regulation and (vi) the U.K. implementation of the Blocking Regulation. Section 4 considers the impact that these issues of legal uncertainty may have on market participants. The paper concludes in Section 5 by proposing some solutions to resolve certain issues of legal uncertainty, where possible. It is notable that many of the issues of uncertainty identified in this paper can only be resolved by further guidance or clarification from the E.U. or from national and/or judicial enforcement authorities within the E.U. and therefore this paper primarily seeks to articulate the issues of uncertainty facing the financial markets as a result of the updated Blocking Regulation, so that market participants can fully understand the risks and issues that they may face in their day-to-day business activities.

2. BACKGROUND TO THE LEGAL FRAMEWORK

U.S. Sanctions in the context of the E.U. Blocking Regulation

Primary and secondary sanctions

- 2.1. In the context of U.S. sanctions on Iran, primary sanctions prohibit U.S. persons (including foreign subsidiaries owned or controlled by U.S. entities) and non-U.S.

persons within the U.S. jurisdiction from directly or indirectly engaging in business activities in Iran or with Iranian counterparties. Since 1995, primary sanctions have largely prohibited U.S. persons from engaging in any business dealings connected to Iran.

- 2.2. U.S. secondary sanctions target activities outside of the U.S. jurisdiction, primarily by non-U.S. companies and/or banks engaged in various business activities with Iranian counterparties. The majority of secondary sanctions were previously lifted by the JCPOA, as described below.
- 2.3. A violation of primary sanctions may lead to civil penalties as well as the risk of criminal prosecution. By contrast, a violation of secondary sanctions does not give rise to direct fines, but can give rise to various consequences which are designed to limit the relevant person's ability to transact with the U.S.⁴
- 2.4. The Office of Foreign Assets Control (“**OFAC**”) of the U.S. Department of the Treasury is responsible for administering and enforcing U.S. sanctions. In recent years, various global banks have been fined by, or have entered into settlement agreements with, OFAC for, *inter alia*, violating certain U.S. sanctions programs.⁵ Some of these cases concerned transactions involving sanctioned countries being processed or cleared through the U.S. financial system; as a result, such transactions were deemed to have taken place on U.S. jurisdiction and involving U.S. persons.

Effect of the JCPOA

- 2.5. The JCPOA is an agreement reached in 2015 between Iran, the E.U. and the P5+1 (the five permanent members of the United Nations Security Council—China, France, Russia, the United Kingdom and the United States—plus Germany).
- 2.6. Under the JCPOA, many of the secondary sanctions imposed on non-U.S. persons for conduct occurring entirely outside the United States jurisdiction were suspended or lifted. Additionally, the JCPOA removed approximately 400 Iranian individuals and entities from the List of Specially Designated Nationals and Blocked Persons (the “**SDN List**”). This meant that non-U.S. persons would no longer be subject to secondary

⁴ Please note, however, the recent settlement between Singapore-based companies CSE/TransTel and OFAC, where the companies paid a \$12 million fine to settle alleged violations of the International Emergency Economic Powers Act and Iranian Transactions and Sanctions Regulations relating to transactions with Iranian counterparties in U.S. dollars which were processed through the U.S. financial system: https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/transtel_settlement.pdf.

⁵ For instance, HSBC was subject to \$1.9 billion fine in 2012 and Commerzbank to a \$1.45 billion fine in 2015.

sanctions for engaging in significant transactions with these previously Specially Designated Nationals (“SDNs”).

- 2.7. By contrast, primary sanctions were generally not lifted by the JCPOA. There were, however, some exceptions, including the adoption of a favorable licensing policy in respect of commercial aviation exports to Iran and related transactions. Under the JCPOA, the United States also agreed to issue certain general licenses, including General License H, which allowed non-U.S. entities owned or controlled by U.S. persons to engage in certain Iran-related transactions.⁶

U.S. Withdrawal from the JCPOA

- 2.8. As a result of the U.S.’s withdrawal from the JCPOA, all secondary sanctions that were lifted or modified under the JCPOA were re-instated, following the two wind-down periods. These included, *inter alia*, sanctions on Iran’s energy sector, Iranian sovereign debt and Iran’s automotive sector. Some of these sanctions were also widened beyond their previous scope.⁷ Certain Iranian entities were re-instated on the SDN List, meaning that non-U.S. persons engaging in business with such entities would now run the risk of becoming subjects of the U.S. secondary sanctions. To the extent that primary sanctions had been modified by the JCPOA, these modifications were also revoked.

Blocking Regulation

- 2.9. The Blocking Regulation was first adopted by the E.U. in 1996, with the purpose of (per the title) “protecting against the effects of the extraterritorial application of legislation adopted by a Third Country, and actions thereon or resulting therefrom”. The Blocking Regulation was initially adopted to counter-act U.S. extra-territorial economic sanctions against Cuba, Libya and Iran.⁸
- 2.10. The Annex sets out the measures that the Blocking Regulation seeks to “block”. In relation to U.S. sanctions against Iran, the Annex (as updated by the Delegated Regulation) now lists five U.S. instruments: the Iran Sanctions Act of 1996, the Iran

⁶ As the paragraph makes specific reference to terms as they appear in the JCPOA, the FMLC has retained the use of the American spelling: licenses.

⁷ Question no. 601 of the *OFAC FAQs: Iran Sanctions*, available online: https://www.treasury.gov/resource-center/faqs/Sanctions/Pages/faq_iran.aspx#601.

⁸ The annex to the Blocking Regulation as originally drafted referred to the following extra-territorial legislation: (i) National Defense Authorization Act for Fiscal Year 1993, Title XVII “Cuban Democracy Act 1992”, sections 1704 and 1706; (ii) Cuban Liberty and Democratic Solidarity Act of 1996; and (iii) Iran Sanctions Act of 1996.

Freedom and Counter-Proliferation Act of 2012, the National Defense Authorization Act for Fiscal Year 2012, the Iran Threat Reduction and Syria Human Rights Act of 2012 and the Iranian Transactions and Sanctions Regulations (together, the “**Blocked U.S. Laws**”). The European Commission has also provided non-binding guidance (the “**Guidance Note**”) on the operation of the updated Blocking Regulation.⁹

2.11. As an E.U. regulation, the Blocking Regulation is directly applicable in the U.K. Pursuant to section 3 of the European Union (Withdrawal) Act 2018,¹⁰ the Blocking Regulation—as an E.U. regulation operative before the U.K.’s withdrawal from the E.U.—will also form part of U.K. domestic law after exit day. A number of amendments have been proposed to ensure its operation in U.K. law.¹¹ This does not restrict changes to the application of the Blocking Regulation in the U.K. in the future, but there is no indication at present that any such changes will be forthcoming.

2.12. Indeed, HM Government has stated its intention to uphold the policy intent of the Blocking Regulation in its statute book once the U.K. has left the E.U., to mitigate the impact of extra-territorial sanctions on the U.K.’s trading interests. The U.K. has stated that it will assume responsibility for listing extra-territorial sanctions legislation with which U.K. businesses must not comply.¹² More generally, it is expected that current E.U. sanctions will also remain in place in the U.K. following Brexit.¹³

2.13. A key provision of the Blocking Regulation is Article 5, which expressly prohibits persons covered by the Blocking Regulation under Article 11 (“**Covered Persons**”) from complying

whether directly or through a subsidiary or other intermediary person, actively or by deliberate omission, with any requirement or prohibition, including requests of foreign courts, based on or resulting, directly or

⁹ *Guidance Note — Questions and Answers: adoption of update of the Blocking Statute*, available online: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.CI.2018.277.01.0004.01.ENG&toc=OJ:C:2018:277:TOC>.

¹⁰ Available online: <http://www.legislation.gov.UK/U.K.pga/2018/16/section/3/enacted>.

¹¹ *Protecting against the Effects of the Extraterritorial Application of Third Country Legislation (Amendment) (EU Exit) Regulations 2019*, available online: http://www.legislation.gov.uk/ukdsi/2019/9780111183229/pdfs/ukdsi_9780111183229_en.pdf.

¹² *Explanatory Memorandum to The Extraterritorial US Legislation (Sanctions Against Cuba, Iran And Libya) (Protection Of Trading Interests) (Amendment) Order 2018 2018 No. 1357*, available online: http://www.legislation.gov.uk/uksi/2018/1357/pdfs/uksiem_20181357_en.pdf.

¹³ See *HM Government’s Sanctions policy if there’s no Brexit deal*, available online: <https://www.gov.uk/government/publications/sanctions-policy-if-theres-no-brexit-deal/sanctions-policy-if-theres-no-brexit-deal>.

indirectly from the foreign laws specified in the Annex, or from actions based thereon or resulting therefrom.¹⁴

2.14. Additionally, the Blocking Regulation provides that:

- there is an obligation to notify the European Commission where the economic or financial interests of a Covered Person are affected by the foreign laws specified in the Annex, or by actions based thereon or resulting therefrom (Article 2);
- neither the E.U. courts nor those of the Member States may recognise or enforce court or administrative decisions giving effect to laws specified in the Annex, or to actions based thereon or resulting therefrom (Article 4);
- the penalties to be imposed for breach of the Blocking Regulation are to be determined by Member States (Article 9); and
- Covered Persons are entitled to recover damages, including legal costs, for losses caused by “the application of the laws specified in the Annex or by actions based thereon or resulting therefrom” (Article 6).

U.K. Implementation of the Blocking Regulation

2.15. The U.K. has implemented Article 9 through the Extraterritorial US Legislation (Sanctions against Cuba, Iran and Libya) (Protection of Trading Interests) Order 1996 (the “**1996 Order**”).¹⁵ Article 2(1) of the 1996 Order provides that where a Covered Person breaches Article 2 or the first paragraph of Article 5 of the Blocking Regulation, this constitutes a criminal offence punishable by a potentially unlimited fine. (There is, however, no custodial sentence available.) Article 2(1) of the 1996 Order also expressly provides that where a breach of Article 2 of the Blocking Regulation is committed by a company, an offence can be committed not only by the company but also by any “director, manager or other person with management responsibilities”.

¹⁴ Article 11 provides that the Blocking Regulation shall apply to: (1) any natural person being a resident in the Community and a national of a Member State, (2) any legal person incorporated within the Community, (3) any natural or legal person referred to in Article 1(2) of Regulation (EEC) No 4055/86, (4) any other natural person being a resident in the Community, unless that person is in the country of which he is a national and (5) any other natural person within the Community, including its territorial waters and air space and in any aircraft or on any vessel under the jurisdiction or control of a Member State, acting in a professional capacity.

¹⁵ As amended by the Extraterritorial US Legislation (Sanctions Against Cuba, Iran And Libya) (Protection Of Trading Interests) (Amendment) Order 2018 2018 No. 1357, available online: http://www.legislation.gov.uk/uksi/2018/1357/pdfs/ukxi_20181357_en.pdf.

Other Member States' Implementation of the Blocking Regulation

- 2.16. E.U. Member States have adopted a varied approach to implementing and enforcing the Blocking Regulation. Some Member States (such as Ireland, the Netherlands and Sweden) have, like the U.K., instituted criminal penalties for breach of the Blocking Regulation. For instance, under Swedish law, a breach of Article 2 or the first paragraph of Article 5 carries a potentially unlimited criminal fine and maximum sentence of 6 months.¹⁶ In contrast to the U.K. approach, other Member States (such as Germany, Italy and Spain) have devised administrative penalties for a breach of the Blocking Regulation. For instance, under German law, the German Foreign Trade and Payments Ordinance (Außenwirtschaftsverordnung or “**AVW**”) makes a breach of the first paragraph of Article 5 an administrative offence punishable by a fine up to a statutory maximum of 500,000 euros.¹⁷ Finally, some Member States (such as France) have not enacted any implementing legislation of the Blocking Regulation.

3. ISSUES OF LEGAL UNCERTAINTY

Definitional Uncertainties

- 3.1. This section identifies and examines various issues of uncertainty that arise when interpreting specific terminology used in certain provisions of the Blocking Regulation. Presently, the interpretation of the Blocking Regulation is ultimately a matter reserved to the European Court of Justice (the “**CJEU**”). The FMLC has, however, analysed ways in which this wording may be reasonably interpreted and highlighted points that it considers would benefit from further clarification.

The terms “comply” and “non-compliance” in Article 5

- 3.2. Article 5, first paragraph, prohibits Covered Persons from:

comply[ing], whether directly or through a subsidiary or other intermediary person, actively or by deliberate omission, with any requirement or prohibition, including requests of foreign courts, based on or resulting, directly or indirectly, from the laws specified in the Annex or from actions based thereon or resulting therefrom.

¹⁶ Lag om EG:s förordning om skydd mot extraterritoriell lagstiftning som antas av ett tredje land (Svensk författningssamling [SFS] 1997:825) (Swed.).

¹⁷ Section 82, para. 2 of the AVW.

Article 5, second paragraph, provides that Covered Persons may be authorised:

to comply fully or partially to the extent that non-compliance would seriously damage their interests or those of the Community.

3.3. As noted above, the interpretation of the Blocking Regulation is ultimately a matter of E.U. law.¹⁸ There is no CJEU case-law interpreting the Blocking Regulation. There is some recent guidance on its intended scope contained in the Guidance Note, though this is non-binding. If, however, one applies the interpretative methods adopted by the E.U. courts, that is to say, if one considers the text of the provisions in light of their context and underlying purpose,¹⁹ it is possible to identify certain parameters to the concept of “comply”.

3.4. The purpose of the Blocking Regulation is set out in Article 1 thereof:

This Regulation provides protection against and counteracts the effects of the extra-territorial application of the laws specified in the Annex of this Regulation, including regulations and other legislative instruments, and of actions based thereon or resulting therefrom, where such application affects the interests of [Covered Persons], engaging in international trade and/or the movement of capital and related commercial activities between the Community and Third Countries.

Interpreting Article 5 in light of the overall purpose of the Blocking Regulation, there are potentially two ways in which the notion of “compliance” under Article 5 may be qualified.

3.5. First, in view of the objective to counter the effects of the *extra-territorial* application of the specified U.S. sanctions, Article 5 should not, in principle, apply to situations when there is no extra-territorial application of the specified U.S. sanctions. There is, however, some uncertainty as to what exactly is considered “extra-territorial” for these purposes (the term itself is not defined). There is also uncertainty regarding the extent to which compliance with both U.S. primary and secondary sanctions may be caught by

¹⁸ The U.K. statutory instrument giving effect to the Blocking Regulation (the 1996 Order) does not add any clarity, as it simply refers to breaches of Article 2 or the first paragraph of Article 5 of the Blocking Regulation without expanding on what these entail.

¹⁹ It is settled CJEU case-law that, “in interpreting a provision of EU law, it is necessary to consider not only its wording but also the context in which it occurs and the objectives of the rules of which it is part. [...] In addition, since the textual and historical interpretations of a regulation, in particular of one of its provisions, do not permit its precise scope to be assessed, the legislation in question must be interpreted by reference to both its purpose and general structure”. See judgment of 28 September 2016 in Case T-437/14 UK v Commission, EU:T:2016:577, paragraphs 59-60.

the Article 5 prohibition. These points are further discussed in sections 3.15 to 3.19 below.

- 3.6. Second, Article 1 states that the Blocking Regulation counteracts the effects of the "extra-territorial application" of the specified U.S. sanctions

where such application affects the interests of [Covered Persons] engaging in international trade and/or the movement of capital and related commercial activities between the Community and Third Countries.

Interpreting Article 5 in light of this objective, prohibited "compliance" should only occur when the application of the specified U.S. sanctions would affect the interests of a Covered Person engaging in international trade or finance between the E.U. and Third Countries (for example, Iran). The notion of a person's "interests" being "affected" is potentially very broad, but in this context Article 1 could be understood as referring to interests arising from the international trade and/or commercial activities in which the person is engaged.

- 3.7. In light of the above, the terms "comply" and "non-compliance" in Article 5 can reasonably be interpreted as meaning a Covered Person bringing its activities in line with the specified U.S. sanctions in the situation where (i) there is an impact on the interests of a person who is engaged in international trade or finance between the E.U. and Third Countries, and (ii) it is the extra-territorial application of the specified U.S. sanctions which affects their interests (noting, of course, the uncertainties surrounding the concept of "extra-territorial application"). In addition, "compliance" must be "actively or by deliberate omission", as discussed below.

- 3.8. In light of the criminal law penalties that could attach to any prohibited "compliance", further guidance on the scope of this concept from the European Commission and/or the relevant U.K. authority would be welcomed.²⁰

Compliance "actively or by deliberate omission"

- 3.9. Article 5 qualifies prohibited compliance as being "actively or by deliberate omission". This can be understood as requiring the act or omission to be driven by the intention to comply with the specified U.S. sanctions, and would exclude acts or omissions that are driven primarily by other considerations.

²⁰ Even though any such guidance would be non-binding (the ultimate arbiter on the interpretation of E.U. legislation being the CJEU), it would at least provide an indication of the risk of enforcement action.

3.10. Such an approach is supported by the Guidance Note, which states:

E.U. operators are free to conduct their business as they see fit in accordance with E.U. law and national applicable laws. This means that they are free to choose whether to start working, continue, or cease business operations in Iran or Cuba, and whether to engage or not in an economic sector on the basis of their assessment of the economic situation. The purpose of the Blocking Statute is exactly to ensure that that such business decisions remain free, i.e., are not forced upon E.U. operators by the listed extra-territorial legislation, which the Union law does not recognise as applicable to them.²¹

In this regard, it is noteworthy that the European Commission has previously indicated that it is not usually possible to establish that a decision not to engage in business activities was as a direct result of U.S. sanctions rather than commercial considerations.²²

3.11. The scope of “actively or by deliberate omission” can therefore be understood as excluding from the scope of the Blocking Regulation acts or omissions that are driven by economic or commercial considerations. It remains unclear whether such considerations must be the *only* matters taken into account by Covered Persons or rather a primary or decisive factor in order to fall outside scope. In practice, it seems likely that a real and substantial commercial issue would be sufficient, even if it was not the only consideration.

3.12. In addition, it is arguable that the same should be true of other considerations, such as compliance with rules on money-laundering and terrorist financing, operational considerations, E.U. sanctions or other U.S. sanctions that are not specified in the Annex. These other compliance considerations are also essential for financial institutions, and can drive decisions on business activities as much as the specified U.S. sanctions in question. There is no guidance on this point, as the Guidance Note only refers to economic considerations. It is difficult, however, to see how actions or omissions driven by other compliance and risk management motives can be said to

²¹ See Guidance Note, Section 1, Question 5.

²² Answer given on 1 April 2015 by Vice-President Mogherini on behalf of the Commission to Parliamentary questions E-007804/2014, available [here](#). This states “*In relation to effects of the US legislation in the EU, it is noted that when EU persons or entities decide not to engage in certain activities, the Commission needs to establish whether or not this is due to commercial business considerations or whether this may be due to the US legislation. It is not usually possible to establish that the decision is a direct result of the US legislation rather than commercial considerations.*”

constitute “active” or “deliberate” compliance with the specified U.S. sanctions. Given the importance of these other considerations for financial institutions, further clarification on this point would be helpful.

The U.S. sanctions against Iran that are covered by the Blocking Regulation

- 3.13. Further issues of uncertainty arise when considering the scope of U.S. sanctions against Iran that are covered by this Article 5 prohibition on “compliance”.
- 3.14. The Annex lists, in relation to Iran, five U.S. laws and regulations (the Blocked U.S. Laws), as set out in paragraph 2.10 above. It does not specify the relevant parts of the Blocked U.S. Laws that fall within the scope of the Blocking Regulation. For each instrument, the Annex summarises the “required compliance” by Covered Persons and the “possible damages to E.U. interests”. The Annex expressly notes, however, that the summaries of the instruments are “only for information purposes. The full overview of provisions and their exact content can be found in the relevant instruments.” This is consistent with the language which is used in the Guidance Note which states that “[t]he provisions of the [Blocked U.S. Laws] having unlawful extra-territorial effects have been summarised in the Annex for ease of reference”, and “for a complete overview, it is necessary to consult the relevant provisions”. Where the Blocked U.S. Laws contain both primary and secondary U.S. sanctions, and given the summaries in the Blocking Regulation do not reference specific provisions of the Blocked U.S. Laws, there is scope for considerable uncertainty as to which specific provisions of the Blocked U.S. Laws are considered, for the purposes of the Blocking Regulation, to have extra-territorial effect and which therefore are within its scope.
- 3.15. Moreover, there is uncertainty surrounding the meaning of the “extra-territorial” application of U.S. sanctions, and as a result, the extent to which the Blocking Regulation also seeks to block compliance with primary U.S. sanctions. As discussed in section 3.8 above, in light of the Blocking Regulation’s purpose, it is understood that the Blocking Regulation only applies to compliance with the relevant U.S. laws (or indeed the laws of any other jurisdiction that are listed in the Annex in the future) or actions based thereon or resulting therefrom in situations where these apply extra-territorially. This suggests that compliance by U.S. persons (even outside the U.S.) with primary U.S. sanctions would not be covered by the Blocking Regulation.²³ By extension, “compliance” with requirements or prohibitions based on or resulting from such

²³ By way of example, Section 4, Question 21 of the Guidance Note provides that E.U. branches of U.S. companies (to which U.S. primary sanctions apply) are not covered by the Blocking Regulation, as they lack separate legal personality from the U.S. companies.

application of primary U.S. sanctions may also fall outside the scope of the Blocking Regulation.

- 3.16. The application of primary U.S. sanctions does not, however, necessarily preclude the application of the Blocking Regulation, as there may be situations where the application of primary U.S. sanctions may still be considered by the E.U. to be extra-territorial. For example, E.U.-incorporated entities which are owned or controlled by U.S. companies are expressly included within the scope of primary U.S. sanctions in relation to Iran, despite being located outside of the U.S. (as a matter of U.S. law). The Guidance Note considers, however, these would be Covered Persons subject to the Blocking Regulation,²⁴ suggesting that such entities would only be complying with U.S. sanctions as a result of their extra-territorial application. In addition, U.S. primary sanctions could be considered as having extra-territorial application in the case of non-U.S. persons carrying out business outside the U.S. involving U.S.-origin goods, or payments in U.S. dollars that clear through the U.S. Given the lack of a clear definition of extra-territoriality, further guidance on the exact situations which the Commission would view as extra-territorial would be helpful.
- 3.17. The question also arises whether it is ever possible to “comply with” U.S. secondary sanctions, given that U.S. secondary sanctions do not lay down any prohibitions or mandatory requirements. Rather, they lay down potential consequences that might arise should a non-U.S. person be involved in specified sanctionable activities. Simply looking at the narrow term “compliance”, it is arguable that actions taken to avoid triggering U.S. secondary sanctions cannot constitute “compliance” prohibited by Article 5. On the other hand, U.S. secondary sanctions are the main way in which U.S. sanctions have extra-territorial effect, so it would be consistent with the overall purpose of the Blocking Regulation that these should be included within its scope. Furthermore, the Annex itself expressly refers to the potential consequences for Covered Persons under secondary sanctions. Further clarification of this point would be welcome.
- 3.18. As part of a risk-based determination, irrespective of the specific sanctions referred to in the Annex, an E.U. person may determine that it would be economically risky to engage in certain activities given the active prosecution environment and high fines under U.S. law. It is not entirely clear whether this decision would breach Article 5, because causatively it would not be taken on the basis of the laws specified in the Annex

²⁴ See Guidance Note, Section 4, Question 21.

but rather as a result of the economic risk that the E.U. person faced by continuing those business activities.

3.19. Moreover, the Guidance Note provides that

the Commission does not regard as compliance with the listed extra-territorial legislation the simple pursuit of conversations with the U.S. authorities in order for E.U. operators to ascertain its exact extent, how it might impact on them and whether not complying with it might entail serious damage on their interests in the sense of Article 5, second paragraph.

It follows from this that it is lawful to perform a review of a company's activities to assess its exposure to U.S. law. More detailed guidance on what sorts of impact assessment are possible would help.

The meaning of "actions" in Article 5

3.20. Along with the issues identified above, there are other instances of definitional uncertainty that arise when interpreting the Blocking Regulation. These are set out below, along with possible interpretations.

3.21. Article 5 prohibits compliance with

any requirement or prohibition, including requests of foreign courts, based on or resulting, directly or indirectly, from the laws specified in the Annex or from actions based thereon or resulting therefrom.

“Actions” in this context can be understood broadly, as referring to any actions based on any requirement or prohibition based on or resulting from the laws specified in the Annex. This may include compliance with actions carried out pursuant to administrative and judicial decisions, but does not appear to be limited to such actions. It could, for example, include compliance with requirements imposed by third persons (e.g. a lender in a financing agreement) if and only to the extent that such a requirement is based on or resulting (directly or indirectly) from the laws specified in the Annex.

3.22. Uncertainty arises in the situation where requirements are being imposed by a U.S. lender, in order to ensure its own compliance with U.S. primary sanctions (a situation which *prima facie* is not extra-territorial). The question arises whether compliance by an E.U. borrower with such requirements would involve the “extra-territorial” application of U.S. sanctions, covered by the Blocking Regulation (particularly where it is the U.S.

primary sanctions which are driving the requirements, not any secondary sanctions). Further guidance on this, in particular whether the Commission would consider this particular situation to be covered by the Blocking Regulation, would be helpful.

The meaning of “affected” in Article 2

3.23. Article 2 provides that Covered Persons must inform the European Commission where their

economic and/or financial interests [...] are affected, directly or indirectly, by the laws specified in the Annex or by actions based thereon or resulting therefrom.

The Recitals to the Blocking Regulation suggest that it is primarily concerned with the "adverse effects on the interests of the community and the interest of natural and legal persons exercising rights under the Treaty establishing the European Community" (emphasis added) of the laws specified in the Annex. The word "affected" could, however, also be taken to include favourable effects.

3.24. Article 2 applies to all Covered Persons, with no specified restrictions in scope. This raises the question as to whether some additional factor is required to trigger the Article 2 notification requirement; otherwise, the application of this requirement could be very broad and potentially impractical (as discussed below).

3.25. In particular, the question arises whether there is a *de minimis* level, below which a Covered Person will not be required to inform the European Commission of the effect of the Blocking Regulation and, if so, what this level is.

3.26. Additionally, Covered Persons may not know the reasons for the “actions” of those with whom they deal. More specific guidance on the precise state of knowledge, suspicion and/or evidence required for reporting would be useful.

3.27. Article 2 could also be construed as requiring self-reporting by Covered Persons. By way of example, a business may elect not to pursue business opportunities in Iran because it no longer considers that they are likely to be practical or profitable as a result of the re-imposition of U.S. sanctions.²⁵ This may affect the business' economic and financial interests in such a way that the requirement to inform the European Commission is triggered. It appears, however, that it would be open to the European Commission to conclude, from the information provided to it, that the business'

²⁵ Guidance Note, Section 1, Question 5 confirms that this is permissible.

decision was actually made in order to comply with the laws specified in the Annex. (Note that the European Commission does not actually prosecute breaches.)

- 3.28. There is, however, a tension between any such obligation to self-report matters which could be alleged as non-compliance with the Blocking Regulation and the right to protection against self-incrimination, which is a general principle that has been recognised, for example, in the context of E.U. competition law²⁶ and under the European Convention of Human Rights.²⁷ The Blocking Regulation must be read in light of this right, and to the extent that it conflicts with this and other aligned principles, could potentially be considered unlawful.²⁸ Further clarity on this point would be welcome.
- 3.29. In addition, questions arise about the protection of confidential information provided to the European Commission under Article 2 notices. In some instances, the mere identity of the companies who have made the notification could be sensitive. Further assurances from the Commission on this point would be welcome.

The meaning of “economic and/or financial interests” in Article 2

- 3.30. Article 2 also qualifies the notification requirement by stating that covered persons are only required to inform the European Commission when it is their "economic and/or financial interests" that are affected (rather than any wider interests). This could be interpreted very broadly, in particular in light of the fact that (a) the Blocking Regulation makes it clear that the European Commission considers it necessary to "remov[e], neutralis[e], [block]" and "otherwise [counter] the effects of the foreign legislation concerned", and (b) Article 2 states that its information requirement will be triggered both where the covered persons are affected "directly" and "indirectly". If this is correct, covered persons may also be required to report any future, anticipated (or likely) effects of the laws specified in the Annex and any losses of opportunity to which they have given rise. This gives rise to uncertainty as to whether Article 2 should be interpreted as referring only to a situation where a covered person's economic and/or financial interests are "affected" in a way which is capable of being demonstrated or

²⁶ Judgments of the European Court of Justice in *Orkem v Commission*, 374/87, EU:C:1989:387, paragraph 35, and *Solvay v Commission*, 27/88, EU:C:1989:388, paragraph 32.

²⁷ Judgment of the European Court of Human Rights (Grand Chamber) of 17 December 1996 in *Saunders v. United Kingdom*, Application No 19187/91, paragraph 68.

²⁸ The European Convention on Human Rights only ensures, of course, the protection of individuals' rights while businesses are likely to be held responsible for any breaches of the Blocking Regulation. A more detailed analysis of whether persons associated with companies might be caught by the Blocking Regulation can be found at paragraph 3.60, below.

evidenced. If this is the case, it may be that the information submitted to the European Commission pursuant to Article 2 should include proof of economic loss.

Approaches to address the Blocking Regulation in Transaction Documentation

Background

- 3.31. Sanctions clauses have developed and become more complex in recent years due to the escalation of sanctions on Russia and the de-escalation and subsequent re-imposition of U.S. sanctions on Iran. A number of market participants, including banks, now have well developed sanctions requirements and standard form wording to be included in documentation.
- 3.32. Since the August 2018 amendments to the Blocking Regulation and issuance of the Guidance Note, market participants have considered again the potential impact of the Blocking Regulation on provisions which are commonly included in transaction documents to address sanctions-related issues.
- 3.33. This section analyses issues of legal uncertainty that arise when addressing parties' sanctions concerns as well as the Blocking Regulation in transaction documentation. The analysis in this section is based on documentation typical for financing transactions, although similar considerations may be relevant for other transactions as well.

Common contractual provisions

- 3.34. As mentioned above, parties typically include a number of different sanctions related clauses in agreements, which may or may not engage the Blocking Regulation, including:
- Day one representations (factual statements as to compliance with sanctions or that a party is not sanctioned);
 - Repeating representations (factual statements as to compliance with sanctions);
 - Repeating representations (factual statement that the Party is not sanctioned);
 - Undertakings (to comply with sanctions);
 - Conditions precedent; and
 - Use of proceeds clauses (e.g., not to use proceeds in sanctioned countries).

- 3.35. The above list is not exhaustive and is intended to give an example of provisions which are capable of engaging the Blocking Regulation primarily by formulating a requirement that may be viewed as limiting a counterparty's activities or requiring it to modify its behaviour. Whether or not the Blocking Regulation would apply depends on a number of factors and may be very situation-specific. Some of those factors are considered in the following section.

Applicability of the Blocking Regulation to contracts

- 3.36. There is no guidance on whether the Blocking Regulation was intended to capture conduct agreed as part of a contract between private counterparties as well as actions carried out pursuant to laws and regulations and administrative and judicial decisions.
- 3.37. As mentioned above, it is also uncertain what "compliance" with the laws listed in the Annex means in the context of a contractual relationship and which party, if the Blocking Regulation does apply, should be viewed as "complying" with the laws listed in the Annex. For instance, while a lender imposing a U.S. sanctions-related requirement may be viewed as complying with the laws in the Annex (subject to an important proviso that imposing such requirements in itself is based on or results from such laws), no guidance is provided with respect to whether a borrower's compliance with such contractual requirements would also be within the scope of Article 5.
- 3.38. As noted above,²⁹ Article 5 is broadly formulated and may be viewed as including compliance with requirements imposed not only by governmental bodies, but also by third persons, including lenders in a financing transaction, again only to the extent that such requirement is based on or results (directly or indirectly) from the laws specified in the Annex.
- 3.39. A recent English court decision sheds some light on the applicability of the Blocking Regulation to contracts.³⁰ It was, in particular, noted that a party merely relying upon the terms of a sanctions clause to resist performing a contractual obligation cannot be construed as an act of "compliance" with a Third Country sanctions regime, and thereby would not breach the Blocking Regulation. The decision, however, is in a particular factual context (the comment was made *in obiter* and based on a contract predating the August 2018 amendments to the Blocking Regulation). It is also not certain that the court (i) would have necessarily reached the same conclusion if the

²⁹ See paragraphs 3.20 and 3.21.

³⁰ *Mamancochet Mining Limited v Aegis Managing Agency Limited and Others* [2018] EWHC 2643 (Comm).

provision required active compliance by a counterparty, rather than operating as an exclusion of liability; and (ii) would reach the same decision again with respect to a contractual obligation which arose *after* the Blocking Regulation was updated.

- 3.40. Assuming the Blocking Regulation does apply to contracts, in both cases mentioned in paragraph 3.37, the proviso that the action shall be based on or result from the laws listed in the Annex appears to provide important limitations to its applicability. In view of the Guidance Note (see paragraph 3.10 above), the question remains as to whether contractual provisions should be deemed affected by the Blocking Regulation if driven by commercial deliberations wholly or partially unrelated to sanctions (e.g., related compliance and risk considerations such as anti-money laundering and anti-terrorism policies). Additionally, it is not clear to what extent a counterparty to which a contractual requirement applies is required to enquire as to the true reasons for inclusion of a contractual provision to determine whether or not its compliance with such provision may engage the Blocking Regulation.³¹
- 3.41. Further uncertainties arise from the scope of the Blocking Regulation. As noted above, the Blocking Regulation applies to persons set out in Article 11, i.e. to Covered Persons.³² Both Covered Persons, and non-Covered Persons who are party to a transaction with a Covered Person, will, however, need to consider the application of the Blocking Regulation when entering into transactions.
- 3.42. Where a transaction is entered into between non-Covered Persons, the Blocking Regulation is unlikely to be relevant, albeit parties may still have to consider its effect, if:
- an additional Covered Person becomes or agrees to become a party to such transaction at a later date; or
 - a non-Covered Person agrees to provide sanctions provisions with respect to Covered Persons who are not party to the documentation (for example, E.U. subsidiaries of that non-Covered Person) and therefore ensures compliance, or seeks assurances from those Covered Persons as to their compliance, with such sanctions provisions.

³¹ See also paragraphs 3.24 and 3.26.

³² See paragraphs 3.45 to **Error! Reference source not found.** for further discussion on legal uncertainties surrounding the scope of Article 11.

- 3.43. At the same time, applying a purposeful reading of the Blocking Regulation, it shall only be engaged where the extra-territorial application of the specified U.S. sanctions affects the interests of [covered persons] engaging in international trade and/or movement of capital and related activities between the Community and Third Countries.³³

The analysis of whether the Blocking Regulation would affect a particular transaction will therefore heavily depend on the specific facts of a transaction and parties involved.

- 3.44. As set out above, the objective of the Blocking Regulation is stated to be the countering of the extra-territorial application of specified U.S. sanctions.³⁴ Consequently, there is the same argument that the Blocking Regulation should not be engaged if sanctions-related requirements are imposed in order for a party to comply with U.S. primary sanctions, e.g., where a U.S. lender extends credit to an E.U. borrower.³⁵ There is, however, no available guidance on how a competent authority might view this argument, particularly in circumstances where a Covered Person is signing up to comply with broad sanctions clauses which have the effect of restricting its ability to do business in Iran.

Jurisdictional Scope of the Blocking Regulation

- 3.45. Various issues of legal uncertainty also arise when considering the jurisdictional scope of the Blocking Regulation. These are considered below.

Scope of the Article 2 reporting obligation

- 3.46. One issue of uncertainty is whether Article 2 of the Blocking Regulation should be interpreted to mean that "directors, managers and other persons with management responsibilities" do not have to be persons fitting within the scope of Article 11 (i.e. a Covered Person) in order for the reporting obligation to apply to them.
- 3.47. The starting point is that where the interests of a Covered Person are affected by the laws specified in the Annex or by actions based thereon or resulting therefrom, Article 2 states that such persons shall inform the European Commission accordingly within 30 days of receiving such information. In the case of the interests of a legal person (i.e. an incorporated company), both Article 2 of the Blocking Regulation and Point 1 of the

³³ See paragraphs 3.6 and 3.7.

³⁴ See paragraph 3.5.

³⁵ See paragraphs 3.13 to 3.19.

Guidance Note make clear that this obligation applies to the directors, manager and other persons with management responsibilities (together, “**Officers**”) in respect of a company. The question then turns to whether this would include Officers, wherever located.

3.48. If the affected person is a Covered Person, then it follows that there is an obligation on that Covered Person to make the relevant notification to the European Commission. It is likely that this obligation is intended to apply to the Officers of a company, wherever located, for a number of reasons. In particular:

- Article 2 is triggered by the interests of, *inter alia*, a Covered Person being affected in a way described in the Blocking Regulation. The requirement for a notification to the European Commission is not triggered by the Officers themselves. In other words, the trigger for a notification to the European Commission under Article 2 is an independent consideration to the character, location or even nationality of the Officers.
- Separately, the Officers of a Covered Person would ordinarily owe a fiduciary duty to the Covered Person to ensure compliance with all applicable laws to which that Covered Person is subject. This would include compliance with the Blocking Regulation, where engaged.

3.49. In practice it is likely that in most cases the Officers of a Covered Person will reside within the E.U. or at least spend a proportion of their time within the E.U. Even in the event that a non-E.U. national Officer of a Covered Person was not based in the E.U., it would seem likely that the reporting obligation of the Covered Person would nonetheless still apply to that Officer for the reasons set out above.

What is the jurisdictional extent of the Blocking Regulation?

3.50. Further issues of uncertainty arise with respect to the jurisdictional extent of the Blocking Regulation, in particular with respect to: (i) non-E.U. nationals who are employees and/or directors of branches of U.S. companies, who are within the E.U., and (ii) E.U. Member State nationals residing outside of the E.U. These issues of uncertainty are considered below, beginning with an underlying analysis of the scope of the Blocking Regulation’s application to legal and natural persons.

Scope of legal and natural persons under the Blocking Regulation

3.51. Unlike the standard form of drafting used in E.U sanctions instruments, the Blocking Regulation does not apply generally to all natural or legal persons within the territory of the E.U. (for the reasons outlined below), nor does it apply to any legal person in respect of any business done in whole or in part within the E.U. There remain various uncertainties regarding the scope of its application, in particular with respect to natural persons.

Legal persons

3.52. E.U.-incorporated companies fall within the jurisdictional scope of the Blocking Regulation (Article 11(2)) and must comply with it.³⁶ Consistent with this approach, the Guidance Note states that branches of U.S. companies in the E.U. do not fall within the scope of the Blocking Regulation because they do not have a distinct legal personality from their non-E.U. parent company (point 21 of the Guidance Note).

3.53. In addition, in certain circumstances, non-E.U. incorporated shipping companies that are controlled by E.U. nationals must also comply with the Blocking Regulation (Article 11(3)).

Natural persons

3.54. In relation to natural persons, the jurisdictional scope of the Blocking Regulation differs in its application to E.U. and non-E.U. nationals as follows.

- E.U. nationals must generally comply with the Blocking Regulation. Specifically, the Blocking Regulation applies to E.U. nationals who are resident in the E.U. (Article 11(1)). It is less clear, however, whether the Blocking Regulation also extends to E.U. nationals that are “established” outside the E.U. This is discussed in more detail in paragraphs 3.60 to **Error! Reference source not found.** below.
- Non-E.U. nationals must comply with the Blocking Regulation in certain circumstances. Specifically, the Blocking Regulation applies to non-E.U. nationals to the extent they are either: (i) resident in the E.U., unless such person is in the country of which he is a national (Article 11(4)); or (ii) within the E.U., where such person is acting in a professional capacity (Article 11(5)).

3.55. Being a “resident in the [E.U.]” is defined as:

³⁶ Note that E.U. subsidiaries of U.S. companies are also within scope of the Blocking Regulation (although see section 3.16 on the uncertainties surrounding the extra-territorial application of U.S. sanctions).

being legally established in the [E.U.] for a period of at least six months within the 12-month period immediately prior to the date on which, under this Regulation, an obligation arises or a right is exercised

While “legally established” is not specifically defined in respect of natural persons, the Right of Establishment under Chapter 2 (Articles 49 to 55) of the Treaty on the Functioning of the European Union suggests that “establishment” should be interpreted to refer to an individual’s physical location.

- 3.56. The jurisdictional extent of the Blocking Regulation therefore appears to be broader for natural persons than for legal persons. Nevertheless, the Blocking Regulation does not apply generally to all natural persons within the territory of the Union since non-E.U. nationals within the E.U. (and who are not resident in the E.U.) only fall within the scope of the Blocking Regulation to the extent they are “acting in a professional capacity” (Article 11(5)). The Guidance Note does not elaborate on what constitutes “acting in a professional capacity” and so there remains a degree of uncertainty around how broadly this provision will be interpreted. By way of example, a natural person providing legal or accounting advice to a company might be among the categories of natural persons acting in a professional capacity intended to fall within Article 11(5).

(i) Non-E.U. national employees and directors of branches of U.S. companies

- 3.57. The Guidance Note clarifies that branches of U.S. entities will not be subject to the Blocking Regulation. The Guidance Note does not, however, address the question of whether the application of the Blocking Regulation to natural persons within the E.U. will include employees and directors of such entities.
- 3.58. It appears that the jurisdictional scope of the Blocking Regulation would extend to employees and directors of branches of U.S. companies, to the extent that they are either: (i) E.U. nationals resident in the E.U.; (ii) nationals of another country resident in the E.U. (while outside of the country of which they are a national); or (iii) within the E.U. and acting in a professional capacity, notwithstanding that the branches themselves are not subject to the Blocking Regulation.
- 3.59. It could be argued that such persons can be liable for breaching Article 5 when acting on behalf of their employer (whether their employer is subject to Article 5 or not). In practice, this will be a very fact specific analysis. For example, activity that constitutes “conduct in compliance with the U.S. sanctions” carried out by the branch of the U.S. entity (which is not subject to the Blocking Regulation) is unlikely by itself to implicate

the non-E.U. national employees of such branches. It is the entity itself that would withdraw from dealings with Iran rather than individual employees (i.e. in their personal capacity).

(ii) E.U. Member State nationals residing outside the E.U.

- 3.60. Point 22 of the Guidance Note states that the Blocking Regulation applies to E.U. Member State nationals resident or established outside the E.U. This does not appear to be aligned with Article 11 of the Blocking Regulation which sets out the legal and natural persons to whom the Blocking Regulation will apply. All but one of the five categories in Article 11 require the natural or legal person to be resident or established in the E.U. Article 11(3), which is the exception, incorporates a reference Article 1(2) of Regulation (EEC) No 4055/86³⁷. That paragraph provides that

The provisions of this Regulation shall also apply to nationals of the Member States established outside the Community and to shipping companies established outside the Community and controlled by nationals of a Member State, if their vessels are registered in that Member State in accordance with its legislation.

- 3.61. This provision does apply to E.U. nationals established outside the E.U., but apparently only *if their vessels are registered in the E.U.* The intention of Article 11(3) seems, therefore, to apply the Blocking Regulation to a small category of E.U. nationals resident or established outside the E.U.

Authorisation Procedure under the Blocking Regulation

- 3.62. The Blocking Regulation allows a Covered Person to apply for an authorisation to “comply fully or partially” with the laws specified in the Annex, to the “extent that non-compliance would seriously damage [that person’s] interests or those of the community” (second paragraph, Article 5). The Blocking Regulation further provides that such authorisation applications will be considered through the E.U. examination procedure, with the assistance of the Committee on Extra-territorial Legislation (Article 8). This requires each authorisation application to be approved by a majority of

³⁷ Regulation (EEC) No 4055/86 of 22 December 1986 applying the principle of freedom to provide services to maritime transport between Member States and between Member States and Third Countries, available online: <https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A31986R4055>.

member state representatives sitting on the Committee on Extra-territorial Legislation (as detailed in Article 5 of Regulation (EU) No 182/2011).³⁸

- 3.63. Commission Implementing Regulation (EU) 2018/1101 (the “**Authorisation Criteria Regulation**”) sets out the practical steps for such an application, which other than basic administrative details requires an applicant to indicate “the precise provisions of the listed extra-territorial legislation or the subsequent action at stake”, “the scope of the authorisation” and “the damage that would be caused by non-compliance” (Article 3 of the Authorisation Criteria Regulation).³⁹ The Authorisation Criteria Regulation then sets out a non-exhaustive list of factors which need to be assessed to determine if the interests of the applicant or the community would be subject to “serious damage”. This list is described specifically as being “non-cumulative” and includes factors such “the existence of ongoing administrative or judicial investigation”, “substantial connecting link with the Third Country which is at the origin of the listed extraterritorial legislation” and “the security of supply of strategic goods or services within or to the Union or a Member State”.
- 3.64. There is currently limited guidance on the types of situations that would potentially qualify for an authorisation under the Blocking Regulation, and there is no public information on whether any such applications have been made or granted. The Guidance Note provides only one specific example: an authorisation may be available in order to allow a Covered Person to apply for a licence from the relevant U.S. authorities (point 23 of the Guidance Note). Further, the Commission’s website and template application form expressly notes that the application process cannot be used to obtain “letters of comfort”, or confirmation that a particular decision is in line with the Blocking Regulation. Beyond that, the Commission’s template allows the application to fill in the desired scope of an authorisation, and provides tick boxes for factors applicable under the Authorisation Criteria Regulation (with space to describe any “other relevant factor”).
- 3.65. Based on the requirement in the Authorisation Criteria Regulation for an application to identify the “precise provisions of the listed extra-territorial legislation or the subsequent

³⁸ Regulation (EU) No 182/2011 of the European Parliament and of the Council of 16 February 2011 laying down the rules and general principles concerning mechanisms for control by Member States of the Commission’s exercise of implementing powers, available online: <https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:32011R0182>.

³⁹ 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 protecting against the effects of the extra-territorial application of legislation adopted by a Third Country, and actions based thereon or resulting therefrom, available online: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32018R1101>.

action at stake”, and the listed criteria for identifying “serious damage”, which seem to envisage the applicant attempting a specific transaction or facing potential enforcement actions, it is possible that such authorisations are intended to be available only for narrow situations in which there is a clearly identifiable adverse consequence for the applicant. It is unclear, however, what level of certainty needs to be established by the applicant in relation to the “serious damage” that it faces, other than the requirement for the application to provide “sufficient evidence” of such consequences. By way of example, it is not clear if it would be sufficient for a Covered Person to show that a contemplated transaction, which is breach of a law covered in the Annex, would cause it “serious damage”, if there is no specific indication that the U.S. authorities would take enforcement action against it, but where if such action were taken, it would have grave consequences for that Covered Person.

- 3.66. Further, as the possible scope of an authorisation is not defined, it is not clear if, theoretically, a Covered Person could apply to be exempt from the Blocking Regulation in its entirety, without the authorisation being linked to a specific transaction, for example on the basis that it is a subsidiary of a U.S. company and so would be unable to continue to operate within the E.U. if it cannot adopt a policy of following the laws set out in Annex 1 of the Blocking Regulation.
- 3.67. An additional ambiguity arises in respect of the likely timeframe required for an application. As the Guidance Note expressly states that an application for an authorisation does not have suspensive effect (question 20 of the Guidance Note), the length of time required for a decision to be made on a particular application will be a key consideration for applicants. At present, however, the Commission has merely stated it would consider an application “as swiftly as possible”, which may make it difficult for Covered Persons to use this process for time critical matters, such as pending transactions or actions required to respond to requests from U.S. enforcement authorities.
- 3.68. The FMLC would welcome clarification regarding these issues of uncertainty in the Blocking Regulation authorisation procedure.

Damages Actions under the Blocking Regulation

- 3.69. Article 6 provides that Covered Persons are entitled to recover damages, including legal costs, for losses caused by “the application of the laws specified in the Annex or by actions based thereon or resulting therefrom”. Article 6 also makes clear that the scope of persons from whom damages can be recovered is very broad:

Such recovery may be obtained from the natural or legal person or any other entity causing the damages or from any person acting on its behalf or intermediary.

The legislation does not, however, address the specific question of whether a Covered Person could recover damages directly from the U.S. government under Article 6, on the grounds that it is the U.S. government which caused the Covered Person to incur losses by re-imposing U.S. sanctions with extra-territorial effect in respect of Iran.

3.70. The Guidance Note goes further in raising this question directly:

From whom can EU operators claim compensation for those damages?
Can EU operators sue the U.S. authorities in order to recover damages?⁴⁰

There is, however, no direct answer given to the latter question. The Guidance Note merely states that the identity of the defendant will depend on a non-exhaustive list of factors including, *inter alia*, “the specifics of the case”, “the kind of damage caused” and “the person or entity actually causing it”. It also notes that the identity of the defendant is a matter for the “competent court” to decide. The Guidance Note, however, re-emphasises the wide scope of application of Article 6:

the wording of Article 6 is very broad, in that it includes not only the responsible persons and entities, but also their representatives, thus allowing a broader scope of protection to EU operators.

The broad wording of Article 6, coupled with the fact that point 14 of the Guidance Note does not expressly reject the possibility of Covered Persons suing the U.S. authorities (but instead just highlights the wide scope of Article 6), may suggest that the U.S. could be the target of a damages action under Article 6, although there are a number of legal and other considerations which EU operators would doubtless wish to consider before venturing down such a path, including the issue of sovereign immunity.

U.K. Implementation of the Blocking Regulation

Relevant U.K. Regulatory Authority

3.71. The FMLC identified some uncertainty regarding which U.K. authority will be responsible for investigations and prosecutions.

⁴⁰ Question 14 of the Guidance Note.

- 3.72. The Guidance Note makes it clear that Member State authorities are responsible for ensuring that the Blocking Regulation is enforced, including in respect of penalties for any breach of the Blocking Regulation. Notwithstanding the latter, the FMLC identified some uncertainty regarding which U.K. authority is responsible for the enforcement of the Blocking Regulation. In this regard, it is notable that despite the European Commission's obligation under Article 7(e) of the Blocking Regulation, it has not to date published the names and addresses of relevant competent authorities of Member States.
- 3.73. Given that the Office of Financial Sanctions Implementation ("**OFSI**") is responsible for the domestic implementation of the U.K.'s international financial sanctions obligations, including in respect of E.U. financial sanctions, there is a belief in some quarters that OFSI might undertake an enforcement role in respect of the Blocking Regulation. OFSI is the U.K.'s "competent authority" for the implementation of E.U. financial sanctions and sits within HM Treasury. As the only recourse for breach of the Blocking Regulation in the U.K. is criminal prosecution, and OFSI does not have any criminal prosecution powers, it seems unlikely that OFSI would actually take on a prosecution role; rather, it seems probable that OFSI would refer such matters on to the Crown Prosecution Service ("**CPS**").
- 3.74. It should be noted, however, that OFSI's role relates exclusively to the implementation and enforcement of financial sanctions. The Blocking Regulation, on the other hand, is much wider in scope, and extends in principle to compliance with all kinds of U.S. prohibitions imposed on the jurisdictions in question, including trade sanctions. Moreover, as noted in section 2.12, the Blocking Regulation is not itself a sanctions regulation but rather a counter-sanctions measure; in this regard, it may be questioned whether OFSI's role would actually be relevant with respect to the enforcement of the Blocking Regulation. Finally, the U.K.'s domestic implementing legislation, the 1996 Order, is linked to the Protection of Trading Interests Act 1980 (the "**1980 Act**"). The 1980 Act was brought into force to deal with the extra-territorial impact of certain provisions of U.S. law in the late 1970s. Although there do not appear to have been any prosecutions of the offences set out in the 1980 Act, that piece of legislation was previously overseen by the Department of Trade and Industry, and now falls within the remit of the Department for International Trade.

- 3.75. The FMLC understands that responsibility for the implementation of the amended Blocking Regulation in the U.K. remains with the Department for International Trade,⁴¹ although it is not clear which authority will enforce it. It is possible that the investigation of offences relating to the Blocking Regulation will be undertaken by HMRC, which is the authority responsible for enforcing breaches of trade sanctions in the U.K., including under the Customs and Excise Management Act 1979. Presumably, HMRC would refer offences relating to the Blocking Regulation on to the Crown Prosecution Service for prosecution.
- 3.76. The FMLC further notes that, regardless of the body formally responsible for investigating and prosecuting of such offences, Section 2(3) of the 1996 Order requires any criminal prosecution pursuant to the 1996 Order to be instituted by the Secretary of State or the relevant Attorney General. This appears to provide additional discretion for the U.K. government on when or if it should attempt to prosecute potential offences under the 1996 Order. There is currently no guidance on what criteria may be considered when applying this discretion.
- 3.77. The FMLC would welcome formal clarification regarding the official body responsible for enforcement of the Blocking Regulation in the U.K.

Intervention in favour of E.U. operators

- 3.78. The Guidance Note poses this question at point 14, but does not give any answer suggesting that clarification is needed from the European Commission.
- 3.79. Under the Blocking Regulation, the role of the European Commission is limited to the following: (i) gathering information provided to it under Article 2; (ii) keeping the European Parliament and Council informed regarding the relevant extra-territorial legislation (Article 7(a)); (iii) granting authorisations (Article 7(b)); (iv) adding or deleting references to legislation deriving from the relevant extra-territorial laws (Article 7(c)); (v) publishing notices in the Official Journal of the European Communities on the judgments and decisions to which Articles 4 and 6 apply (Article 7(d)); and (vi) publishing in the Official Journal the names and addresses of the competent authorities of the Member States (Article 7(e)).
- 3.80. Moreover, the competent authorities of Member States are only referred to obliquely in the text of the Blocking Regulation; they are given no clear role in respect of its

⁴¹ The domestic legislation implementing the Blocking Regulation in 2018 was laid before Parliament by the Department for International Trade. See, footnote 12, *supra*.

implementation or enforcement. It is notable, therefore, that point 14 of the Guidance Note poses the following questions:

How can damages [under Article 6] be claimed? Will the Commission or national authorities intervene in favour of E.U. operators?

- 3.81. In respect of the second question, although no direct answer is provided, the Guidance Note suggests that the European Commission or relevant national authority might somehow play a role in the recovery of damages available to E.U. operators under Article 6. In particular, the Guidance Note points out that

Article 6 specifies that recovery could take the form of seizure and sale of assets which the natural or legal person or entity causing the damages [...] holds in the Union [...].

In this regard, it is clear that the seizure of assets could not occur without the intervention of national or European authorities. It is therefore possible that the Guidance Note is suggesting that national authorities, including national courts, should make themselves available to assist in the process of seizing assets in the event that an award of damages is made to an E.U. operator under Article 6.

Mens rea under the U.K. implementation of the Blocking Regulation

- 3.82. As discussed, the Blocking Regulation is implemented in the U.K. by way of the 1996 Order. Under Article 2(1) of the 1996 Order, a specified person who commits a breach of Article 2 or the first paragraph of Article 5 of the Blocking Regulation will be guilty of a criminal offence in the U.K.
- 3.83. Importantly, Article 2(1) of the 1996 Order does not set out a mental element for the commission of the relevant offence. This may be contrasted with most U.K. domestic legislation implementing E.U. sanctions prohibitions (noting, of course, that the Blocking Regulation is not itself a piece of sanctions legislation). For example, the Syria (European Union Financial Sanctions) Regulations 2012 provide that a person must not deal with funds or economic resources belonging to, held or controlled by, a designated person if that person knows or has reasonable cause to suspect that he or she is dealing with such funds or economic resources.⁴² By contrast, for example, under Swedish law, a breach of Article 2(1) only attracts a fine or imprisonment where there is

⁴²

Available online: http://www.legislation.gov.uk/uksi/2012/129/pdfs/ukxi_20120129_en.pdf.

intention or gross negligence.⁴³ On its face, therefore, Article 2(1) of the 1996 Order is capable of being interpreted as creating a strict liability offence whereby, for example, if a person who is resident in the U.K. complies with one of the laws set out in the Annex to the Blocking Regulation, he or she commits an offence.

3.84. It should be noted in this regard that Article 5(1) of the Blocking Regulation itself introduces the qualification that, in order to breach the prohibition on compliance, a person must “actively or by deliberate omission” comply with the relevant extra-territorial laws set out in the Annex. This indicates that, at least with regards to breach by omission, the omission must be deliberately intended by the person in question. Presumably the same applies to positive steps taken by a person actively to comply with the relevant laws. Indeed, this accords with what is set out in the Guidance Note regarding business in Iran or Cuba. In particular, point 5 of the Guidance Note states that E.U. operators are

free to choose whether to start working, continue, or cease business operations in Iran or Cuba, and whether to engage or not in an economic sector on the basis of their assessment of the economic situation.

3.85. It therefore stands to reason that if, for example, steps taken by a person to unwind business in Iran could be interpreted simultaneously as (i) a free business decision made for commercial reasons, and (ii) a decision to comply with U.S. sanctions in breach of the Blocking Regulation, some examination of the person’s intent must be required in order to distinguish between the two. In other words, it is strongly arguable that the criminal offence under Article 2(1) of the 1996 Order incorporates a mental element such that the offence requires proof that the person in question intended to comply with U.S. extra-territorial sanctions, as opposed to making a business decision on purely commercial grounds. In this regard, evidence of why a person took a decision, for example, to cease doing business in Iran, would be relevant in relation to the prosecution of the offence under Article 2(1) of the 1996 Order.

3.86. Moreover, the wording of Article 5 of the Blocking Regulation should be contrasted with the wording of Article 2 of the Blocking Regulation. Article 2 creates the separate obligation for a person to inform the European Commission where his or her economic or financial interests are affected by the U.S. laws in question. Whereas Article 5(1) contains the qualification discussed above regarding compliance “actively or by

⁴³ Lag om EG:s förordning om skydd mot extraterritoriell lagstiftning som antas av ett tredje land (Svensk författningssamling [SFS] 1997:825) (Swed.).

deliberate omission”, Article 2 contains no such qualification. As a result, the conclusion might be drawn that whilst a breach of Article 2 gives rise to strict liability under Article 2(1) of the 1996 Order, a breach of Article 5 does not.

- 3.87. Given the potential consequences involved in a breach of the Blocking Regulation, clarification regarding the mental element requirement under Article 2(1) of the 1996 Order, and regarding the elements of the offence contained in that provision, would help resolve the uncertainties identified above.

4. IMPACT

- 4.1. The revision of the Blocking Regulation and the issues of legal uncertainty flagged throughout this paper have had an impact on U.K. business and the financial markets, particularly on Covered Persons who engage in substantial business activity connected to the U.S. or rely on U.S. lenders to finance their business activities, given the many issues of uncertainty identified in this paper as to how such persons can properly navigate (if possible) two conflicting legal regimes which apply to them and their business.
- 4.2. Most obviously, the revision of the Blocking Regulation has affected the market approach to financing agreements in the U.K. (and elsewhere) with a range of different approaches to enhanced drafting to account for the re-imposition of U.S. secondary sanctions and the extension of the Blocking Regulation. Parties in the process of agreeing or amending their existing financing may need to engage more closely with the various possible approaches on a case-by-case basis. Some possible approaches that have been identified to the FMLC by market experts are set out in Appendix A to this paper.
- 4.3. The Blocking Regulation has also affected market participants in various other ways. For instance, the Blocking Regulation and relevant guidance on sanctions are affecting the internal compliance systems of E.U. lenders, particularly those with U.S. links who are required to comply with two largely conflicting sets of obligations imposed by the U.S. on the one hand and the E.U. on the other. Finally, there has been a real impact on individual senior employees, officers and directors of U.S. businesses or subsidiaries of U.S. businesses operating within the E.U. who remain heavily concerned at their risk of personal liability under the Blocking Regulation for implanting the orders and requirements of their employer in accordance with U.S. primary sanctions.

5. SOLUTIONS AND MITIGANTS

- 5.1. Specific issues of uncertainty identified in this paper which can be assisted by further guidance are summarised below.

Definitional Issues

- 5.2. The interpretation of the Blocking Regulation is ultimately a matter of E.U. law, with the ultimate arbiter on such interpretation being the CJEU. Given the absence of any CJEU case-law on the Blocking Regulation, however, further guidance from the European Commission and/or the relevant U.K. authority would help clarify the issues of definitional uncertainty identified in this paper. In particular, clarification would be welcomed with respect to (i) the scope of “comply” and “non-compliance” in Article 5; (ii) the nature of “extra-territorial” application of U.S. sanctions, and the scope of primary and secondary sanctions that are caught by the Blocking Regulation; (iii) the meaning of “actions” under the Article 5 prohibition, and in particular whether this extends to a situation where requirements are being imposed by a U.S. lender, in order to ensure its own compliance with U.S. primary sanctions; (iv) whether there is a *de minimis* level at which Covered Persons’ “economic and/or financial interests” are deemed “affected” by the laws specified in the Annex, and whether Article 2 contains an element of self-reporting; and (v) the scope of “affected” “economic and/or financial interests” under the Article 2 reporting obligation.

Applicability of the Blocking Regulation to Contracts

- 5.3. There remain various uncertainties surrounding the extent to which the Blocking Regulation may capture contracts between private counterparties, as well as actions carried out pursuant to laws, regulations and administrative and judicial decisions. Contractual parties will need to closely consider, on a fact specific basis, the possible impact of the Blocking Regulation on their contracts and the effectiveness of any sanctions wording that they have inserted therein. Some possible approaches identified by market experts are set out in Appendix A.

Jurisdictional Scope

- 5.4. Further guidance on the jurisdictional scope of the Blocking Regulation would be useful. In particular, clarification would be welcomed with respect to: (i) whether “directors, managers and other persons with management responsibilities” under the Article 2 reporting obligation have to be persons fitting within the scope of Article 11;

(ii) whether non-E.U. national employees and directors of branches of U.S. companies, who are within the E.U., are caught under the scope of Article 11; and (iii) whether E.U. Member State nationals residing outside of the E.U. are subject to the Blocking Regulation.

Authorisation Procedure under the Blocking Regulation

- 5.5. The FMLC would welcome further clarification regarding (i) the types of situations that would potentially qualify for an authorisation under the Blocking Regulation; (ii) the level of certainty needs to be established by the applicant in relation to the “serious damage” criteria; (iii) the possible scope of authorisations that may be granted; and (iv) the likely timeframe required for a decision to be made on an application for authorisation.

Damages Actions

- 5.6. While the Article 6 provision for recovering damages is broadly drafted, it does not address the specific question of whether a Covered Person could recover damages from the U.S. state itself under Article 6, on the grounds that the U.S. authorities caused the Covered Person losses by re-imposing U.S. sanctions on Iran. An analysis of state immunity principles suggests that this would be a difficult line of argument for Covered Persons to pursue, but given the uncertainty, clarification on this point would be welcome.

U.K. Implementation of the Blocking Regulation

- 5.7. The FMLC would welcome clarification from the relevant U.K. authorities and/or European Commission, as applicable, regarding (i) the entity responsible for enforcement of the Blocking Regulation in the U.K., (ii) whether the European Commission or relevant national authority might somehow play a role in the recovery of damages available to E.U. operators under Article 6 and (iii) the *mens rea* element required under Article 2(1) of the 1996 Order.

6. CONCLUSION

- 6.1. In this paper, the FMLC has examined the various issues of legal uncertainty that arise under English law as a result of the amendment of the Blocking Regulation to cover re-imposed sanctions on Iran. In Section 3, the FMLC raised various issues of legal uncertainty arising with respect to (i) specific terminology used in key provisions of the

Blocking Regulation, (ii) the applicability of the Blocking Regulation to private counterparties, (iii) the jurisdictional scope of the Blocking Regulation, (iv) the use of the authorisation procedure, (v) the ability to bring damages claims against a state entity under the Blocking Regulation and (vi) the U.K. implementation of the Blocking Regulation. In Section 4, the FMLC considered the impact that these issues of legal uncertainty may have on market participants, including on E.U. businesses who rely on financing from lenders connected to the U.S. and on the individuals who may be at personal risk of being required to comply with two conflicting sets of requirements. In Section 5, the FMLC emphasised that clarity on these issues—particularly from the relevant U.K. and E.U. authorities—would help ensure greater legal certainty in the financial markets and give market participants clarity as to how their obligations apply in practice. The FMLC has included at Appendix A a summary of drafting approaches which can be considered by market participants to help manage some of the uncertainties which arise in respect of the market standard representations and undertakings relating to sanctions compliance which are typically included in financing and similar agreements which the FMLC hopes is of assistance.

APPENDIX A

- 1.1. Commentators have drawn to the Committee’s attention to approaches which could be adopted by market participants where the Blocking Regulation is engaged in the context of the common contractual clauses as potential market-based solutions. The FMLC does not, however, comment on the effectiveness of these approaches.

A ‘carve out’

- 1.2. One option is to retain the broad wording of the sanctions clauses but clarify in a separate clause or sub-clause that the broad sanctions clauses are not applicable to the extent they are inconsistent with the Blocking Regulation. This approach is consistent with the approach adopted with respect to the German anti-boycott laws, which has been accepted by the market for some time, as discussed further below.

The German anti-boycott approach

- 1.3. It has been common practice for a number of years for German resident parties to include a ‘carve out’ in documentation to address the German anti-boycott law, which prohibits German residents from making a declaration with respect to U.S. extra-territorial sanctions. (It should be noted, however, that the broader context and purpose of the German anti-boycott law is different to the Blocking Regulation, and also pre-dates the Blocking Regulation by many decades. Therefore, it may be of limited assistance as a point of comparison.)
- 1.4. German resident lenders have adopted various approaches to such carve-outs. Some have their own preferred carve out wording. It has been common to see a “Restricted Lender” concept, which allows German lenders to ‘opt out’ of the benefit of certain clauses to the extent they believed receiving the benefit of the clauses would cause them to breach the anti-boycott law.
- 1.5. Whilst some agreements since August 2018 have dealt with the German anti-boycott and Blocking Regulation in the same carve out, market participants have not generally revised their approach to the German anti-boycott provisions in light of the Blocking Regulation developments.
- 1.6. The German anti-boycott approach has historically been extended on some transactions to include the Blocking Regulation (as then in force), although most market participants considered that the Blocking Regulation had limited application to their transactions.

Post-August 2018 carve outs

- 1.7. Since August 2018, carve outs have been used in transactions to clarify that, despite the sanctions clauses being sufficiently broad to capture U.S. extra-territorial sanctions, such clauses should not apply to the extent they would be inconsistent with the Blocking Regulation.
- 1.8. Market experts have informed the FMLC that different approaches to carve out wording could be adopted in the context of different transactions, including:
 - a general clause providing that nothing in the particular agreement shall be interpreted in such a way as would result in a breach of the Blocking Regulation;
 - a more targeted clause, which specifies which clause(s) should not be interpreted in such a way as would result in a breach of the Blocking Regulation; or
 - a more substantial clause similar to the German anti-boycott clauses which allows a party to opt in or opt out of the benefit of certain clauses, as well as inclusion of a mechanism which sets out how parties who have opted out of the benefit of certain clauses may not vote with respect to any issues arising out of those clauses (including waiving breaches, amending etc.).

The final wording agreed may be dependent on a number of factors. In particular, it may vary from the prohibition on interpreting the provisions in a particular way (as suggested above) to stating that they do not apply to a person “if and to the extent that such clauses would be unenforceable by reason of breach of the Blocking Regulation”. Another formulation clarifies that particular provisions are only given “to the extent permissible under the Blocking Regulation”.

The FMLC also understands that some market participants have amended the interpretation provisions in transaction documents so as to specifically state that there is no intention by the parties to breach the Blocking Regulation or further stipulating that the contractual provisions are merely intended to allocate the risks and are not intended to restrict the counterparties from dealings with other persons using means and resources not implicating the relevant transaction.

Other issues

- 1.9. The August 2018 amendments to the Blocking Regulation have caused some market participants to consider whether different approaches to Iran country-risk generally (i.e.

taking into account broader considerations, such as political and money laundering risk) may be required. Previously, concerns relating to Iran may not have been addressed separately in documentation since the broad sanctions clauses were sufficient to capture different kinds of Iran risk.

- 1.10. Some market participants have therefore considered the introduction of a “Restricted Jurisdiction” concept, listing relevant jurisdictions in which they do not wish their counterparties to use their funds. What constitutes a “Restricted Jurisdiction” varies depending on context. In some circumstances, parties have agreed that the concept would capture countries listed by the Financial Action Task Force (FATF) as non-cooperative in the global fight against money laundering and terrorist financing, calling them "Non-Cooperative Countries or Territories" (NCCTs)). Though this remains a transaction-specific issue and there is not yet a general market approach with respect to this concept, there is a general recognition in the market that any such restrictions must be based on a genuine policy that is capable of being evidenced.

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