

Updating the Blocking Regulation

The EU's answer to US extraterritorial sanctions

SUMMARY

On 8 May 2018, President Trump announced the unilateral US withdrawal from the Joint Comprehensive Plan of Action (JCPOA), the landmark nuclear agreement signed by Iran and the E3/EU+3 – France, Germany, the UK and the EU plus China, Russia and the USA – in 2015. He also announced that the US would re-impose sanctions on Iran that had been lifted as part of the implementation of the JCPOA. These sanctions have extraterritorial effect, essentially making it illegal for EU companies and financial institutions to engage in a wide range of economic and commercial activities with Iran. Companies that disregard the US secondary sanctions face major fines and/or criminal charges in the US, or even exclusion from the US market. US sanctions will be reinstated after a 90- or 180-day wind-down period, to allow companies to make the necessary arrangements.

Following the signing of the JCPOA in 2015, European companies have entered into important commercial and investment agreements with Iranian counterparts, worth billions of euros. Many of these companies also have important commercial ties with the US. Faced with the prospect of penalties in the US, several EU companies have already announced that they are ending their dealings with Iran, unless a way can be found to exempt or shield them from US secondary sanctions. In response, the Commission adopted a delegated act on 6 June 2018 to update the annex to the 'Blocking Regulation', which was adopted in 1996 to protect EU businesses against the effects of the extraterritorial application of legislation adopted by a third country. The Blocking Regulation forbids EU persons from complying with extraterritorial sanctions, allows companies to recover damages arising from such sanctions, and nullifies the effect in the EU of any foreign court judgment based on them. The effectiveness of the regulation as a mechanism to offset US sanctions has been questioned, however its adoption sends an important political message. Parliament now has two months to object to the delegated act, but may signal earlier that it will not do so, thus allowing the measure to come into force earlier than the end of the two-month period.



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US sanctions on Iran

The United States has imposed [restrictions on activities](#) with Iran under various legal authorities since 1979, following the seizure of the US Embassy in Tehran. Many of these sanctions, especially those that affect non-US companies, were suspended or lifted as part of the implementation of the JCPOA. Moreover, exemptions and licences were issued to allow for limited engagement of US companies with Iran. On 8 May 2018, President Trump [announced](#) that all sanctions waived as part of the implementation of the JCPOA would be reinstated, and all licences and exemptions be revoked, after a 90- or 180-day wind-down period. Below is a [non-comprehensive summary](#) of the relevant sanctions:

(a) Primary sanctions were never lifted under the JCPOA

Since 1995, US legislation has prohibited US persons from engaging in almost any business dealings with individuals or entities in Iran, including a ban on investments. These primary US sanctions were essentially not lifted by the JCPOA, with some exceptions. Most importantly for the EU, a favourable licensing policy was put in place in respect of exports of commercial passenger aircraft and related parts and services. This carve-out was created to allow US-based Boeing and EU-based Airbus to export [US\\$40 billion worth](#) of aircraft to Iran. As part of the re-imposition of sanctions, the licence will be revoked by 6 August 2018. Airbus is subject to US restrictions on exports to Iran because more than 10 % of the parts on its jets originate from US companies.

US law prohibits US firms, including any foreign subsidiaries that are controlled by the US parent, from dealing with Iran. However, a licence – 'General Licence H': authorising certain transactions relating to foreign entities owned or controlled by a United States person – was published on 16 January 2016 as part of the sanctions relief agreed under the JCPOA. It authorised non-US companies that are owned or controlled by US persons to engage in almost all forms of civilian trade with Iran (provided the US parent had no involvement). This licence, which affects companies based in the EU but controlled by a US parent, will be revoked, with the revocation taking full effect on 4 November 2018.

US sanctions have also focused on excluding Iran from the international banking system. US regulations still ban Iran from direct access to the US financial system. Moreover, US dollars cannot be directly transferred to an Iranian bank, but must be channelled through an intermediary financial institution. US banks are also barred from handling any indirect transaction with Iranian banks, namely transactions with non-Iranian foreign banks that are handling transactions on behalf of Iranian banks. This ban remained in effect throughout the implementation of the JCPOA.

(b) All nuclear-related secondary sanctions reinstated

Secondary sanctions, many of which were lifted or modified as part of the implementation of the JCPOA, will be reinstated after a 90- or 180-day wind-down period. These affect non-US companies and/or banks engaged in the following commercial activities with Iranian counterparts:

From 7 August 2018, the US will re-impose sanctions on	From 5 November 2018, the US will re-impose sanctions on
the Iranian government's purchase of US dollar banknotes;	petroleum-related transactions with the National Iranian Oil Company (NIOC), Naftiran Intertrade Company (NICO), and National Iranian Tanker Company (NITC), including the purchase of petroleum, petroleum products, or petrochemical products from Iran;

Iran's trade in gold and other precious metals;	Iran's port operators, and shipping and shipbuilding sectors, including the Islamic Republic of Iran Shipping Lines (IRISL), South Shipping Line Iran, or their affiliates;
direct or indirect sale, supply or transfer to or from Iran of graphite, raw or semi-finished metals like aluminium and steel, coal and software for integrating industrial processes;	transactions by foreign financial institutions with Iran's Central Bank and other designated Iranian financial institutions;
significant transactions related to the sale or purchase of Iranian rials or the maintenance of significant funds or accounts of rials outside Iran;	the provision of specialised financial messaging services to Iran's Central Bank and other designated Iranian financial institutions;
significant transactions related to the sale or purchase of Iranian rials or the maintenance of significant funds or accounts of rials outside Iran;	the provision of underwriting services, insurance, or reinsurance for transactions with Iran;
Iranian sovereign debt;	Iran's energy sector.
Iran's automotive sector.	

The [Iran Sanctions Act](#) (ISA), enacted in 1996, has been a pivotal component of US sanctions against Iran's energy sector for over 20 years. It contained the first major extraterritorial sanctions on Iran. Many of its provisions were waived to implement the JCPOA. In conjunction with the 8 May 2018 US withdrawal from the JCPOA, US sanctions on Iran's energy sector will come back into effect as of 5 November 2018. Transactions that are considered violations of the ISA include investments to develop Iran's oil and gas fields, and the transport of Iranian crude oil. The French group [Total](#) has warned that it will not continue its project to develop the biggest gas field in the world in Iran unless it obtains a specific project waiver from the US authorities. The two Danish oil shipping companies [Maersk](#) and [Torm](#) have announced that they plan to wind down their dealings with Iran.

Other US provisions impose sanctions on companies that provide insurance or reinsurance for the National Iranian Oil Company (NIOC) or the National Iranian Tanker Company (NITC); or purchase or facilitate the issuance of sovereign debt of the government of Iran, including Iranian government bonds.

An executive order issued in 1992 imposes sanctions, and bars banks from the US financial system, for activities related to the purchase of oil, other petroleum or petrochemical products from Iran, and transactions with designated Iranian oil companies. There are also penalties on transactions with Iran's central bank.

(c) Specially designated nationals list

The US Treasury keeps a list of [specially designated nationals](#) (SDN), a list of individuals and companies owned or controlled by, or acting for or on behalf of, countries targeted by sanctions. It also lists individuals, groups and entities designated under programmes that are not country-specific (such as on counter-terrorism). The assets of persons on the list in the US are blocked, and US persons are generally prohibited from dealing with them. To implement the JCPOA, many Iranian entities were 'delisted' from the SDN list. US persons or foreign entities owned or controlled by US persons continued to be prohibited from conducting business with these entities, but this restriction no longer applied to non-US persons, companies or banks. However, the US Office of Foreign Assets Control (OFAC) will put certain Iranian entities – such as the National Iranian Oil Company (NIOC) and Naftiran Intertrade Company (NICO) – back on the SDN List. This means that non-US persons who engage in activities with these entities will – as of 5 November 2018 – run the

risk of infringing US secondary sanctions. Foreign entities that violate the above provisions might be penalised. Any bank that knowingly facilitates a financial transaction on behalf of an Iranian SDN will be prohibited from operating in the US.

(d) New sanctions

President Trump and newly appointed US Secretary of State, Mike Pompeo, have announced that the US will also impose new sanctions on Iran, referring to them as the 'strongest sanctions in history'. The [Countering America's Adversaries Through Sanctions Act \(CAATSA\)](#) introduces additional sanctions with regard to Iran. There are a number of other possible sanctions that might receive consideration – either in a global or multilateral framework.

Consequences for companies and financial institutions

Violators of US sanctions can be subject to criminal and civil penalties. Moreover, US law provides for a range of specific sanctions against entities that violate the restrictions on activities with Iran. The entity concerned can currently become subject to a maximum of five of the following sanctions:

- denial of export-import bank loans, credits, or credit guarantees for US exports to the sanctioned entity;
- denial of US bank loans exceeding US\$10 million in one year to the entity;
- if the entity is a financial institution, a prohibition on its service as a primary dealer in US government bonds; and/or a prohibition on its serving as a repository for US government funds;
- a prohibition on US government procurement from the entity;
- prohibitions in transactions in foreign exchange subject to the jurisdiction of the USA (i.e. US\$) by the entity;
- prohibition on any credit or payments between the entity and any US financial institution;
- prohibitions and limitations for banks regarding the opening and maintenance of correspondent accounts in the US;
- prohibition of the sanctioned entity from acquiring, holding, using, or trading any US-based property in which the sanctioned entity has a (financial) interest;
- restriction on imports from the sanctioned entity;
- a ban on a US person from investing in or purchasing significant amounts of equity or debt instruments of a sanctioned person;
- exclusion from the US of corporate officers or controlling shareholders of a sanctioned firm;
- imposition of any of the Iran Sanctions Act (ISA) sanctions on principal officers of a sanctioned firm;
- denial of licences for the US export of military or militarily useful technology to the entity;
- refusal of landing, and port-calling restrictions for vessels.

Moreover, a mandatory sanction for any violating entity is the prohibition on contracts with the US government. Companies, as a condition of obtaining a US government contract, must certify to the relevant US government agency that the firm – and any companies it owns or controls – are not violating the ISA.

US secondary sanctions have [extraterritorial effect](#). This means that they affect non-US companies, prohibiting them from engaging with Iranian counterparts. If these companies have no exposure in the US, extraterritorial sanctions against them will be difficult to enforce. However, a company that has a US subsidiary, has US citizens on its board or operates in the US, provides scope for US sanctions to be enforced against it. These can range from massive penalties to prohibition of access. For example, [fines for banks](#) that breach US sanctions have reached billions of dollars.

Regulation (EC) 2271/96 – the Blocking Regulation

[Regulation \(EC\) 2271/96](#), known as the 'Blocking Regulation', was first adopted on 22 November 1996 to protect EU businesses 'against the effects of the extraterritorial application of legislation adopted by a third country'. The EU initially adopted the regulation in 1996 as a countermeasure to US extraterritorial economic sanctions against Cuba, Libya and Iran, which EU governments argued benefited US foreign policy interests at the expense of the sovereignty of EU Member States. The annex to the Blocking Regulation sets out the measures the regulation seeks to 'block'. On 6 June 2018, the European Commission adopted a [delegated act](#) to update the annex to the Blocking Regulation. Once adopted, the revised annex will include the recent US measures on Iran (For the purposes of this briefing, US laws concerning Cuba that also feature in the annex to the Blocking Regulation are disregarded).

(a) The main provisions of the Blocking Regulation

- [Regulation \(EC\) 2271/96](#) only covers the extraterritorial [application](#) of the laws set out in its annex (see (b) US measures targeted by the Blocking Regulation).
- The regulation applies only to 'persons' listed in Article 11, including EU nationals (i.e. nationals of one of the EU Member States), EU residents (meaning legally established in the Community for a period of at least six months within the 12-month period immediately prior to a date relevant to the application of the regulation) and companies incorporated in one of the EU Member States. The regulation also applies to any person 'in the territorial waters or air space' of the EU and in any 'aircraft or on any vessel under the jurisdiction or control of a Member State, acting in a professional capacity'.
- The regulation only covers such persons when they engage in 'international trade and/or movement of capital and related commercial activities between the EU and third countries' (Article 1).
- Persons whose economic and/or financial interests are directly or indirectly affected by the US sanctions set out in the annex are under an obligation to inform the European Commission within 30 days of the date on which they became aware that they are so affected (Article 2).
- Judgments issued by US courts applying the US laws set out in the regulation's annex are not enforceable before the courts of the EU (Article 4).
- Moreover, a person covered by the regulation is prohibited from complying 'whether directly or through a subsidiary or other intermediary person, actively or by deliberate omission', with any requirement or prohibition based on or resulting from the US laws listed in the annex (Article 5).
- The regulation includes a mechanism that allows companies to ask the European Commission for an exemption from this prohibition if they can demonstrate that compliance with the regulation would 'seriously damage their interests' or the interests of the EU (Article 5).
- Article 9 provides that each Member State is to decide what sanctions are to be imposed for breach of the regulation. The regulation merely requires that sanctions be 'effective, proportional and dissuasive'.
- At the same time, Article 6 enables EU persons covered by the US sanctions 'to recover any damages, including legal costs, caused to that [EU] person by the application of the sanctions'. 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'. Recovery could take the form of 'seizure and sale of assets held by those persons or entities'.

(b) US measures targeted by the updated Blocking Regulation

The revised annex to the Blocking Regulation lists the US legal provisions that EU persons or entities will not be allowed to comply with. On Iran, these include:

- The Iran Sanctions Act of 1996, which focuses on significantly curtailing foreign investments in Iran's petroleum industry, or delivery of goods and services to that industry.

- The Iran Freedom and Counter-Proliferation Act of 2012, focuses on significantly reducing foreign support to the ports, energy, shipping or shipbuilding sectors in Iran; as well as prohibiting petroleum purchases from Iran and related financial transactions, transactions in natural gas to and from Iran, trade in precious metals, and providing insurance, reinsurance and underwriting services to Iranian entities.
- The National Defense Authorization Act for Fiscal Year 2012 prohibits significant financial transactions with the central bank of Iran or other designated Iranian financial institutions.
- The Iran Threat Reduction and Syria Human Rights Act of 2012 also prohibits underwriting services, insurance and reinsurance to certain Iranian persons, and makes it illegal to facilitate the issuance of Iranian sovereign debt. It also makes it illegal to engage in any transactions with the government of Iran.
- The Iranian Transaction and Sanctions Regulation, which prohibit the re-export to Iran of any goods, technology and services that have been exported from the US and are subject to export control rules in the US.

Once in force, the updated Blocking Regulation will make it illegal for EU companies or banks to comply with these US sanctions. Any natural or legal EU person that violates this prohibition can be sanctioned by the authority of the Member State with jurisdiction over the person in question. However, in order to enforce this provision, the Commission has to establish, for example, that a company that is no longer conducting business with Iran is acting pursuant to US legislation, rather than simply implementing a commercial decision. As the Commission has [admitted](#) in the past, 'It is not usually possible to establish that the [company's] decision is a direct result of the US legislation rather than commercial considerations'.

(c) Past use of the Blocking Regulation

There are very few instances of the Blocking Regulation being used in practice. There is no jurisprudence at the EU level. In [2007](#), Austria brought charges for breach of Regulation (EC) 2271/96 against [BAWAG](#), at the time the fifth-largest Austrian bank. The charges were based on the Austrian Federal Law on the Punishment of Offences against the Provisions of EC Regulation (EC) No 2271/96. BAWAG had closed the accounts of 100 Cuban nationals. Having Cuban clients would have prevented the acquisition of BAWAG by a US investor, Cerberus Capital, at a time when US Cuban sanctions made it illegal for US companies to deal with Cuba. Following a public uproar, and after [US authorities](#) agreed to grant BAWAG an exemption, BAWAG reinstated the accounts held by Cuban nationals. Cerberus Capital's acquisition of BAWAG went ahead as planned and the investigation against BAWAG for breach of Regulation (EC) 2271/96 was [discontinued](#).

Mitigating the effects of US sanctions on EU entities

Commentators have raised questions about the [effectiveness](#) of the Blocking Regulation as a mechanism to offset the effects of re-instated US sanctions on Iran, at least from an economic or commercial point of view, citing the following reasons:

- Companies engaging in business with Iran would have to [stop using the dollar](#), used in about 90 % of global transactions. They would also have to stop using data that goes through the US.
- While the Blocking Regulation might shield a company from fines imposed by the US – by compensating EU companies for whatever costs they incurred as a result of US sanctions – it cannot shield the company from the practical effects of sanctions imposed on it. These may include [asset seizures](#) and even criminal charges in the US; a prohibition on any credit or payments between the entity and any US financial institution; restriction on imports from the sanctioned entity; a ban on a US person from investing in or purchasing significant amounts of equity or debt instruments from a sanctioned person; and exclusion from the US of corporate officers or controlling shareholders of a sanctioned firm.
- The links between European [multinationals](#) and the US financial system are much deeper today than they were in 1996.

- The Blocking Regulation can do nothing to stop financial institutions that engage in transactions with Iran from losing access to the US financial system. By way of example, a foreign bank that processes payments through Iran's central bank may in future be prevented from opening an account in the US, or find that strict limitations are imposed on existing accounts. This provision may even be applied to foreign central banks, if the transactions concern Iranian oil purchases.
- Many EU companies would be faced with the dilemma of having to choose between doing business in the US or in Iran; given the size and importance of the US market, many will choose the US. Medium-sized EU companies with little or no US exposure could continue to conduct business in Iran in non-dollar currencies. However, [multinationals](#) with important economic interests in the US may simply prefer to pull out of Iran.
- The Blocking Regulation may actually harm EU companies, which will face the [choice](#) of incurring fines in the US (for non-compliance with US sanctions) or in the EU (for complying with US law).
- Compared with 1996, when the idea of a 'blocking regulation' was conceived, US sanctions targeting financial transactions have become more robust and costly for EU firms. European Commission Vice-President Valdis Dombrovskis, Commissioner responsible for financial services, has questioned the effectiveness of a revised Blocking Regulation, especially [for banks](#), given the international nature of the banking system and in particular the exposure of large systemic banks to the US financial system and US dollar transactions.

The Swift case

The [Society for Worldwide Interbank Financial Telecommunication](#) (SWIFT) is a Belgian company that provides an international system for facilitating cross-border payments. The company operates a huge secure messaging service for 11 000 financial institutions, transmitting payment requests across its electronic platform, and keeping a record of these transactions on servers in Europe and the US. In 2012, SWIFT had to disconnect Iranian banks that were subject to sanctions, but Iranian banks were reconnected when the JCPOA came into effect in 2016. To avoid renewed US extraterritorial sanctions on Iran, SWIFT will have to cut off specific Iranian banks from its network by 6 November 2018, or face US countermeasures. These could include asset freezes and US travel bans for board members, as well as restrictions on banks' ability to do business in the US. The Blocking Regulation will allow the company to seek compensation for US penalties through EU courts. At the same time, if SWIFT disconnects Iranian banks to avoid US penalties, it risks violating the EU Blocking Regulation. Keeping Iranian banks in SWIFT is deemed essential to encouraging SMEs to conduct business in Iran, but to do so, US authorities will have to grant the company an exemption from US sanctions.

The Blocking Regulation as bargaining chip

The legal provisions of the regulation enable companies that violate US extraterritorial sanctions and suffer damages as a result of the application of US sanctions, to recover such damages, including legal costs, through EU courts. Such recovery may be obtained 'from the natural or legal person causing the damages' or from any person acting on their behalf. Recovery could take the form of the 'seizure and sale of assets held by the US person, entities, or persons', including shares held in a company incorporated in the EU. The provision provides protection for companies and banks that find themselves – perhaps unwittingly – subject to US sanctions.

Moreover, the adoption of the revised Blocking Regulation sends a political message to the US government. In 1996, the Blocking Regulation was introduced as part of a broader European campaign, which also included a dispute process against the US at the World Trade Organization (WTO). Taken together, these actions gave the EU greater clout in negotiations with the US administration. In 1998, the two sides reached a political solution under which US authorities did not actively enforce extraterritorial sanctions on EU companies still doing business with Cuba.

The EU is hoping for exemptions from US secondary sanctions for EU companies. In a [letter](#) sent on 4 June 2018, France, Germany, the UK and the High Representative of the EU for Foreign Affairs and Security Policy/Vice-President of the Commission demanded that the US government commit to not enforcing US secondary sanctions on EU banks and companies engaging with Iran, especially in key sectors such as energy, automotive, civil aviation and infrastructure sectors.

Political agreement with the US on sanctions in 1998

In 1996, the US adopted the [Cuban Liberty and Democratic Sanctions \(Libertad\)](#) Act, known as the Helms-Burton Act, which included extraterritorial sanctions against Cuba. Considering that the US legislation was in conflict with international law and harming EU rights and interests in the trade and investment sectors, the EU decided to seek [consultations](#) with the US in the World Trade Organization (WTO). Amid threats of an escalating trade dispute, in April 1997, the EU and the US reached an accommodation, in the form of a 'first understanding', covering sanctions against Cuba as well as Iran and Libya. The EU subsequently agreed to suspend the WTO case, on condition that the US commit to working towards neutralising the effects of the Helms-Burton Act and the Iran-Libya Sanctions Act (ILSA) on EU companies and individuals. In May 1997, Parliament adopted a [resolution](#) on the Helms-Burton Act and the ILSA; in September 1997, Parliament adopted a [resolution](#) condemning the Helms-Burton Act. In both resolutions, Parliament urged the Commission to pursue its case at the WTO against US extraterritorial policies. In April 1998, the European Commission announced that it would allow its WTO case against the Helms-Burton Act to lapse, to help bilateral negotiations with the US, but that it would revive the appointed dispute panel if the US took actions under its sanctions law against any EU company. At a bilateral EU-US summit in May 1998, a package of measures was agreed, that in essence would freeze the [application](#) of the controversial sanction laws with regard to EU investments in Cuba, Libya and Iran. The agreement confirmed the EU's stand against the use of secondary boycotts and legislation with extraterritorial effect.

The European Parliament and the Blocking Regulation

On 6 June 2018, the European Commission adopted the delegated act updating the annex to Regulation (EC) 2271/96. The delegated act was referred to Parliament on the same day, the Committee responsible is the Committee for International Trade (INTA). In accordance with [Rule 105 of its Rules of Procedure](#), Parliament has two months from reception of the delegated act on 6 June 2018 to object to the measure, but may signal earlier that it will not object. INTA is scheduled to debate the delegated act on 20-21 June 2018. INTA may table a reasoned opinion for a resolution objecting to the delegated act. If INTA does not table such a resolution, a political group or Members reaching at least the low threshold (i.e. 38 MEPs) may do so. Any motion for a resolution shall state the reasons for Parliament's objections and may incorporate a request calling on the Commission to submit a new delegated act that takes account of Parliament's recommendations. Alternatively, INTA may recommend that, prior to the expiry of the two-month deadline for objection, Parliament should declare that it has no objections to the delegated act. Council will also have two months from reception of the delegated act to object to the measure, or signal its non-objection before the end of that period. The Council of Ministers decides by qualified majority vote. The Commission is hoping that the update of the annex to the Blocking Regulation can come into force before the first set of US secondary sanctions on Iran are due to be re-imposed, on 7 August 2018.

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