Milbank

17 August, 2018

CONTACT

Tom Canning
Partner
+44-20-7615-3047
tcanning@milbank.com

Dara Panahy
Partner
+1-202-835-7521
dpanahy@milbank.com

Paul Kinninmont
Associate
+44-20-7615-3133
pkinninmont@milbank.com

Bijan Ganji
Associate
+1-202-263-7543
bganji@milbank.com

Lafayette Greenfield
Associate
+1-202-835-7564
lgreenfield@milbank.com

Litigation & Arbitration Group Alert: US Sanctions and the EU Blocking Regulation: "Catch 22"

INTRODUCTION

On May 8, 2018, the President of the United States of America (the "**U.S. President**") announced the withdrawal of the United States from the Joint Comprehensive Plan of Action (the "**JCPOA**") related to Iran,[1] and, consequently, began a process to re-impose certain sanctions on Iran that have extraterritorial effect. In response, the EU adopted a delegated act on June 6, 2018 to amend its Blocking Regulation[2] (the **"Amended Regulation**") to prohibit EU individuals and entities ("**EU Persons**") from complying with such U.S. sanctions, once re-imposed.

The Amended Regulation may force EU Persons that are engaged in commercial dealings in, with or involving Iran to choose between risking the scrutiny of, or enforcement action by, U.S. or EU sanctions authorities. It may also affect entities that have no prior dealings with Iran – such as borrowers subject to ongoing general sanctions compliance warranties to lenders as a condition of financing transactions – for reasons considered below.

WHICH U.S SANCTIONS AGAINST IRAN ARE RELEVANT?

In connection with the U.S. President's withdrawal from the JCPOA, the U.S. government is in the process of re-instituting the nuclear-related sanctions against Iran (the "**U.S.-Iran Sanctions**"), subject to 'wind-down' periods of 90 or 180 days, depending on the particular sanction.[3] The U.S.-Iran Sanctions apply to non-U.S. individuals and entities (including EU Persons) and prohibit such individuals and

[1] Signed between Iran, Germany, the USA, the UK, the EU, China, Russia and France in Vienna on 14 July 2015. In exchange for Iran halting its nuclear programme, the other signatories granted relief from sanctions and other benefits.
[2] Council Regulation (EC) No 2271/96; Commission Delegated Regulation C(2018) 3572 of 6 June 2018. The Blocking Regulation was originally adopted on November 22, 1996 as a countermeasure to certain U.S. extraterritorial sanctions against Cuba, Libya and Iran.
[3] The 90-day wind-down period concluded on August 6, 2018 and the 180-day wind-down period concludes on November 4, 2018.

entities from engaging in a range of business and commercial activities in, with or involving Iran. As such, it is prudent for EU Persons that currently have, or intend to have, commercial ties to Iran to be aware of the restrictions, and associated penalties, under the U.S.-Iran Sanctions.

For further information regarding the re-imposition of the U.S.-Iran Sanctions, please refer to Milbank's client alert on this subject, available here.

TO WHOM DOES THE AMENDED REGULATION APPLY?

The Amended Regulation applies to all EU Persons, defined to include:

- EU nationals;
- Almost all EU residents;
- Entities incorporated in the EU; and
- Any person or entity within EU territory, including EU territorial waters and air space, that is acting in a professional capacity, but only if such person or entity is engaged in international trade between the EU and non-EU member states, including in financings and through undertakings in financial documents.

The Amended Regulation came into effect on 7 August 2018. It is important to note that the Amended Regulation applies to EU Persons even in cases where such EU Persons have entered into contracts governed by non-EU or non-EU member state laws.

WHAT DOES THE AMENDED REGULATION AIM TO DO?

The Amended Regulation aims to prevent the extraterritorial effect of the U.S-Iran Sanctions by:

- Prohibiting EU Persons from complying with the U.S-Iran Sanctions, either actively or by deliberate omission;
- Prohibiting the enforcement of foreign judgments that give effect to the U.S-Iran Sanctions;
- Enabling the recovery of damages caused by non-compliance with the U.S-Iran Sanctions from the entity (or intermediary) causing such damages; and
- Requiring any EU Person whose economic or financial interests are affected by the U.S.-Iran Sanctions to report to the EU Commission within 30 days of becoming aware that it is so affected.

WILL THE AMENDED REGULATION BE ENFORCED?

Historically, the Blocking Regulation was never fully enforced due to political accommodations, but such accommodations appear unlikely to continue in the current geopolitical climate.

Assuming no accommodations, various issues in respect of the Amended Regulation will clearly arise, including, by way of illustration only:

- **Proving an intent to comply** with the U.S.-Iran Sanctions, as opposed to a commercial decision by a business not to conduct business in Iran, may be difficult.
- **The threat of U.S. penalties** will mean that any assistance available through the Amended Regulation may be of little comfort. The protection offered by the Amended Regulation still leaves parties open to adverse effects of non-compliance with the U.S.-Iran Sanctions, such as asset seizure, criminal charges, and the denial of access to the U.S. financial system.

EXAMPLE: FINANCIAL INSTITUTIONS

U.S. regulatory authorities, such as the Office of Foreign Assets Control of the U.S. Department of the Treasury, aggressively enforce compliance with U.S. sanctions, and in particular, scrutinize financial institutions given their central role in facilitating the transfer and exchange of currency for commercial actors. For financial institutions, the threat of U.S. sanctions is particularly severe because of their dependence on the U.S. banking system for clearing transactions denominated in U.S. dollars. To minimise their risk in this regard, most financial institutions conduct anti-money laundering and sanctions-related due diligence of customers and related counterparties, and require customers to make extensive sanctions-related representations, warranties and covenants, whether or not such customers have any dealings with Iran. In cross-border contexts implicating both the United States and the EU, such representations, warranties and covenants in certain cases account for conflicts between U.S. sanctions and the Blocking Regulation by disclaiming applicability of such contractual terms to the extent that compliance therewith would give rise to a potential violation of the Blocking Regulation. Historically, this approach was relatively effective in mitigating risk relating to the conflict between U.S. sanctions and the Blocking Regulation, but it will likely be less effective now that the U.S.-Iran Sanctions are being re-imposed and the Amended Regulation has come into force as financial institutions may no longer effectively be able to assure themselves of the compliance of their customers with U.S.-Iran sanctions through contractual means.

EXAMPLE: CONTRACTUAL DIFFICULTIES

Below are only a few possible "Catch 22" issues with common boilerplate clauses by way of illustration:

- Might a representation to comply with all applicable sanctions be taken to constitute evidence of an intention to comply with U.S. sanctions, enabling enforcing authorities in the EU to prove such compliance more easily (see above)?
- In circumstances where a party represents to comply with all applicable U.S. sanctions, subject to a carve-out in respect of those covered by the Amended Regulation, might there be a breach of contract regardless of the regime with which the party decides to comply? What do the parties do in such circumstances?
- If one party relies on an Amended Regulation-related carve-out to the detriment of the other and/or the detriment of contractual performance – following U.S. enforcement action, for instance – what contractual recourse does the other party have, if any?

POSSIBLE SOLUTIONS?

Presently, there are only two possible solutions, neither of which has yet proven to be reliable:

- Affected EU Persons can seek authorisation from the EU to comply with the U.S.-Iran Sanctions, if non-compliance would seriously damage their economic or financial interests. However, seeking such authorisation involves a complex procedure and, if a request for authorisation is denied but the relevant applicant company continues to comply with the U.S.-Iran Sanctions, such continued compliance may provide a basis for EU regulatory authorities to establish proof of an intention to comply with the U.S.-Iran Sanctions.
- The EU may seek, on behalf of EU persons, a waiver from the United States. The EU has already requested waivers for EU entities, but, based on public statements made by U.S. officials to date, it appears unlikely that such waivers will be granted.

CONCLUSION

Commercial entities with any exposure to Iran should perform risk analyses as soon as possible. Commercial entities being asked by banks to provide contractual commitments in respect of U.S. sanctions should negotiate with the benefit of specialist advice. Going forward, careful consideration should be given to legal risks that may flow from obligations under conflicting sanctions regimes in the EU and the United States.

*****

This Client Alert is not comprehensive as to the full scope of the JCPOA, U.S. sanctions against Iran or the Amended Regulation, and is only a summary of certain key actions taken by the United States or the EU relating to the United States' withdrawal from the JCPOA.

LITIGATION AND ARBITRATION GROUP

Please feel free to discuss any aspects of this Alert with your regular Milbank contacts or any of the members of our Litigation and Arbitration Group.

LONDON
10 Gresham Street, London EC2V 7JD, England

Tom Canning	tcanning@milbank.com	+44-20-7615-3047
Charles Evans	cevans@milbank.com	+44-20-7615-3090
Julian Stait	jstait@milbank.com	+44-20-7615-3005

WASHINGTON, DC
1850 K Street, NW, Suite 1100, Washington, DC 20006

David S. Cohen	dcohen2@milbank.com	+1-202-835-7517
Andrew M. Leblanc	aleblanc@milbank.com	+1-202-835-7574
Michael D. Nolan	mnolan@milbank.com	+1-202-835-7524
Aaron L. Renenger	arenenger@milbank.com	+1-202-835-7505

NEW YORK
28 Liberty Street, New York, NY 10005

Wayne M. Aaron	waaron@milbank.com	+1-212-530-5284
Antonia M. Apps	aapps@milbank.com	+1-212-530-5357
Thomas A. Arena	tarena@milbank.com	+1-212-530-5828
George S. Canellos	gcanellos@milbank.com	+1-212-530-5792
James G. Cavoli	jcavoli@milbank.com	+1-212-530-5172
Scott A. Edelman, *Firm Chairman*	sedelman@milbank.com	+1-212-530-5149
Christopher J. Gaspar	cgaspar@milbank.com	+1-212-530-5019
David R. Gelfand	dgelfand@gmail.com	+1-212-530-5520
Katherine R. Goldstein	kgoldstein@milbank.com	+1-212-530-5138
Robert C. Hora	rhora@milbank.com	+1-212-530-5170
Atara Miller	amiller@milbank.com	+1-212-530-5421
Sean M. Murphy	smurphy@milbank.com	+1-212-530-5688
Daniel M. Perry	dperry@milbank.com	+1-212-530-5083
Tawfiq S. Rangwala	trangwala@milbank.com	+1-212-530-5587

Stacey J. Rappaport	srappaport@milbank.com	+1-212-530-5347
Fiona A. Schaeffer	fschaeffer@milbank.com	+1-212-530-5651
Jed M. Schwartz	jschwartz@milbank.com	+1-212-530-5283
Alan J. Stone	astone@milbank.com	+1-212-530-5285
Errol B. Taylor	etaylor@milbank.com	+1-212-530-5545
Fredrick M. Zullow	fzullow@milbank.com	+1-212-530-5533

LOS ANGELES
2029 Century Park East, 33rd Floor, Los Angeles, CA 90067

Robert J. Liubicic	rliubicic@milbank.com	+1-424-386-4525
Jerry L. Marks	jmarks@milbank.com	+1-424-386-4550
Mark Scarsi	mscarsi@milbank.com	+1-424-386-4580