

BRIEFING

DEALING WITH SANCTIONS AND ANTI-BOYCOTT MEASURES UNDER GERMAN AND EUROPEAN LAW IN FINANCING TRANSACTIONS

AUGUST 2016

- CONFLICT OF LAWS MAY ARISE IF MORE THAN ONE JURISDICTION IS INVOLVED
- CONFLICT ISSUES THAT MAY ARISE UNDER DIFFERING SANCTIONS REGIMES SHOULD BE ADDRESSED BY TAILOR-MADE CONTRACTUAL ARRANGEMENTS
- VIOLATIONS OF THE PROHIBITION OF BOYCOTT DECLARATIONS ARE PUNISHABLE BY A FINE UP TO €500,000



SUMMARY

Where a cross-border deal is subject to sanctions laws, a particular conflict may arise. The presence of US citizens may mean US sanctions would apply in a situation where UN, EU or German law may not. In certain circumstances, EU and German law may prohibit compliance with those sanctions laws via blocking statutes. How can this conflict of laws be resolved so that neither the sanctions laws nor the blocking statutes are infringed?

- **Avoidance of sanctions:** through due diligence, it may be possible to show that sanctions do not apply and so no conflict will arise with blocking statutes.
- **Structuring the deal to avoid conflicts:** where blocking statutes may apply to some parties but not others, the former can be carved out of those parts of the transactions that would be subject to sanctions laws. We set out specific rules to follow for both mandatory prepayment provisions and representations and undertakings.

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“IN CROSS-BORDER FINANCING TRANSACTIONS, CONFLICTS MAY OCCUR IF THE JURISDICTION OF A PARTY INVOLVED EXPRESSLY PROHIBITS ADHERENCE TO SPECIFIC SANCTIONS... ”

INTRODUCTION

German foreign trade law contains an obligation to comply with national and European embargo rules. Simultaneously, the embargo regimes of third states – particularly the United States – exist, which are not congruent to the aforementioned rules but claim to have extraterritorial effect.

In cross-border financing transactions, conflicts may occur if the jurisdiction of a party involved expressly prohibits adherence to specific sanctions that would apply to the transaction at hand. German lenders bound by section 7 of the German Foreign Trade Ordinance (*Außenwirtschaftsverordnung*, “AWV”) and Regulation (EC) No 2271/96 (the “EU Blocking Regulation”) may be affected, since provisions common in loan documentation (e.g. mandatory prepayment obligations, representations and undertakings regarding compliance with sanctions) may not be sufficiently specific unless such sanctions-related provisions are adapted to satisfactorily address potential conflicts between different sanction regimes. A similar issue may arise if lenders request sanctions wording that may put a borrower in breach of section 7 of the AWV and/or the EU Blocking Regulation.

The briefing first discusses different approaches to address conflicting sanctions regimes in loan agreements, focussing on German lenders. This is followed by a short overview of the legal background.

HOW TO DEAL WITH SANCTIONS IN LOAN AGREEMENTS

In commonly used financing documentation, the following provisions are relevant in respect of sanctions:

- Mandatory prepayment in case of illegality and, more specifically, breach of sanctions.
- Representations and undertakings as to the compliance with sanctions.
- Events of default in case of non-compliance.
- Restrictions regarding permitted transferees in terms of future parties, e.g. new shareholders of the borrower etc.

In international financing transactions with a lending consortium consisting of lenders that are subject to the German AWV or the EU Blocking Regulation, as well as those that are required to fully comply with, among other things, all US sanctions, each of the above-mentioned common and essential provisions could trigger conflicts, unless specifically amended in order to allow both groups of lenders to fully comply with the relevant sanctions regime by which they are bound, including any blocking regulations.

To solve such conflicts the following approaches may be considered:

a) *Initial due diligence*

Each lender should be able to document and demonstrate that, based on checks regarding the borrower, the borrower’s group of companies, the applicable jurisdictions and the envisaged use of funds, it had no reason to suspect that either the borrower or the transaction are subject to sanctions. Such due diligence satisfactory to all lenders will enable the parties to comply with the applicable sanctions regimes, including any blocking regulations. Moreover, it may serve as evidence in the context of potential investigations by authorities – should they question whether a person has actually committed a

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criminal offence or is subject to a fine because of non-compliance with sanctions. For this purpose, it is advisable that a written report is prepared and kept on file. This approach could be supported by corresponding management confirmations.

Of course, due diligence always reflects the state of affairs at a particular point in time, and thus could not serve as a solution regarding future changes to the parties.

b) Specific carve outs

Further to initial due diligence that is satisfactory to all lenders, the documentation should accommodate the aforementioned differences in the span and range of different sanctions regimes and resulting potential conflicts between sanctions regimes and blocking regulations. Hence, all sanctions-related provisions need to differentiate between conflicting sanctions regimes and the parties bound thereto, and should provide for specific rules tailored to each of such groups of sanctions and lenders.

With respect to German or EU-based lenders that are bound by the AWV or the EU Blocking Regulation, this means that the application of any sanctions-related undertakings, representations etc. may need to be limited to the extent that sanctions regimes of third states are not relevant, in case the relevant lender would otherwise violate section 7 of the AWV or the EU Blocking Regulation. Hence, each of the relevant provisions should be concluded separately between:

- (i) the borrower and those lenders that need to comply with all relevant sanction regimes including those of the US; and
- (ii) the borrower and the lenders that cannot comply in such a broad fashion due to the applicable anti-boycott rules.

i. Mandatory prepayment due to illegality and breach of sanctions

The relevant mandatory prepayment provisions should be adjusted to differentiate between:

- (i) illegality in general; and
- (ii) breach of sanctions regimes as a trigger for the right of a lender to demand prepayment of its participation in the loan.

Since the right to demand a prepayment is similar to a right to refuse performance, it might be regarded as a separate boycott declaration and, hence, the relevant provision needs to expressly take into account the anti-boycott rules applicable to a specific group of lenders. As explained below, it would otherwise be uncertain whether German or EU courts would treat such a provision as valid and enforceable. A solution may be to treat lenders that are bound by anti-boycott rules as “Qualified Lenders”. A breach of sanctions has to be disregarded by such a Qualified Lender pursuant to applicable anti-boycott law must not entitle a Qualified Lender to cancel its participation in the loan and receive a prepayment by

the borrower, whereas the sanctions infringement would be a prepayment event for all other lenders.

ii. Representations and Undertakings

Similarly, representations and undertakings regarding compliance with sanctions regimes should be given separately to the different groups of lenders and with respect to the different sanctions regimes. Hence, representations and undertakings for the benefit of Qualified Lenders need to carve out all sanctions that have to be disregarded by such group of lenders pursuant to the applicable anti-boycott rules.

In the case of a syndicate of banks, appropriate language needs to be included in the loan documentation taking into account that there might be a breach of sanctions and thus a default only vis-à-vis a certain group of the lenders, given that the Qualified Lenders may have to disregard a breach of a sanctions regime. Therefore, the voting procedure in connection with defaults, waivers and consequences of sanctions-related defaults should take into account that Qualified Lenders may need to be permitted to abstain from voting in this context.

Of course, it must be carefully considered how this would work in practice. Even if Qualified Lenders are allowed to abstain from voting with respect to consequences of a breach of sanctions, the decision taken by the relevant majority of lenders would always apply to the lending consortium as a whole and thus also to the Qualified Lenders, even if they did not vote on the issue. Hence, even the Qualified Lenders may be considered to participate in this decision and the question arises as to whether against this background the Qualified Lenders are still in full compliance with the applicable anti-boycott rules. Whilst most of the participants in the financing sector view this approach as sufficient to ensure full compliance with the relevant anti-boycott rules, this has not yet been confirmed by case law.

CONCLUSION

To mitigate the sanctions risks in general, sanctions-specific due diligence by the contracting parties is required, and is of vital importance to demonstrate that all reasonable measures have been taken to comply with sanctions laws.

In addition, sanctions-specific provisions should be drafted carefully. The conflict issues that may arise under differing sanctions regimes can be addressed by tailor-made contractual arrangements on a transaction-specific basis.

THE LAW (SECTION 7 OF THE AWW / EU BLOCKING REGULATION)

a) Section 7 of the AWW

According to section 7 of the AWW, the issuing of a declaration in foreign trade and payment transactions whereby a resident participates in a boycott against another country (a "boycott declaration") is prohibited. The reasoning behind this provision is the protection of Germany's trade relations with other states.

As far as we are aware, there is no published case law on the application of section 7 of the AWW, and it is unclear if, and to what extent, the competent authorities would pursue violations of this provision. However, the German

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Federal Ministry of Economics has included the provision in two explanatory ministerial circulars¹ as well as an information letter dated 20 April 2010.

i. Scope of application

The prohibition of issuing/participating in a boycott declaration in foreign trade and payment transactions applies only to German nationals (both natural and legal persons) and branches of foreign legal persons if the management of the branch is based in Germany and separate accounts are kept for that branch, according to section 2 XV of the German Foreign Trade and Payment Act (*Außenwirtschaftsgesetz – AWG*).

Section 7 of the AWV does not apply to sanctions covered by UN, EU or German legislation.

Examples of declarations of legal relevance covered by section 7 of the AWV include declarations regarding business relations to a boycotted state, black-list clauses, negative declarations of origin, questionnaires regarding business relations to a boycotted state and export restrictions.

A mutually binding promise of contractual partners not to perform the contract should such performance collide with the boycott regulations of a third state is also understood to be a forbidden boycott declaration. In this context, a clause that provides for mandatory prepayment or defines the breach of a sanctions rule as an event of default can also be seen to promote and encourage adherence to the third state sanctions regime, because the party that violates the relevant sanctions will suffer adverse contractual consequences. General language requiring compliance with applicable laws and regulations and sanctions regimes of an undetermined number of states can also be covered by section 7 of the AWV once it is applied to a particular boycott law of a third state.

ii. Consequences of violation

Violations of the prohibition of boycott declarations are punishable by a fine, whether committed wilfully or negligently. Such fines can be up to €500,000 (section 81, paragraph 1, no. 1 of the AWV, section 19, paragraph 6 of the AWG).

Under German civil law, a contract provision that violates section 7 of the AWV may be considered invalid. The remainder of the contract will remain in force, provided that it can be assumed that the contract would have been concluded even without the provision in question.

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¹ *Runderlass Außenwirtschaft* Nr. 27/92, BAnz Nr. 139, 29 July 1992, p. 6142 and *Runderlass Außenwirtschaft* Nr. 31/92, BAnz Nr. 177, 19 September 1992, p. 7849.

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b) EU blocking regulation (regulation no. 2271/96)

On a European level, Regulation (EC) No 2271/96 (“EU Blocking Regulation”) Article 5 forbids compliance with any requirement or prohibition based on/resulting from certain US sanction laws specified in the Annex of the EU Blocking Regulation, for example LIBERTAD. According to the preamble, the EU Blocking Regulation’s purpose is to abolish restrictions on international trade.

i. Scope of application

According to Article 11, the EU Blocking Regulation applies, among other things, to all natural persons residing in the EU and nationals of a Member State, as well as to legal entities incorporated within the EU.

There is no European court case law pertaining to the application and interpretation of the EU Blocking Regulation. In principle, the EU Commission can grant authorisation to deviate from Article 5 of the EU Blocking Regulation, but, similarly, there are no published decisions available.

ii. Consequences of violation

Violations of the EU Blocking Regulation are punishable under national law, even if committed negligently. Under German law, a breach of Article 5, paragraph 1 of the EU Blocking Regulation constitutes an administrative offence under section 82, paragraph 3 of the AWW, which can be punished by a fine of up to €500,000.

iii. Relation to Sec. 7 AWW

Given that EU law takes precedence over the national rules of the Member States, the EU Blocking Regulation would supersede section 7 of the AWW where a conduct falls within the ambit of both legal regimes. The prohibition in Article 5 of the EU Blocking Regulation is more comprehensive than the German law because it prohibits any compliance – even in an indirect fashion – with requirements or prohibitions under relevant sanctions regimes, whereas section 7 of the AWW contains only a prohibition of boycott declarations.

FOR MORE INFORMATION

Should you like to discuss any of the matters raised in this Briefing, please speak with a member of our team below or your regular contact at Watson Farley & Williams.



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