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BRIEFING

US SECONDARY SANCTIONS ON IRAN AND THE EU BLOCKING STATUTE: IMPLICATIONS FOR THE SHIPPING INDUSTRY

AUGUST 2018

- HOW CONFLICT ARISES FOR THE SHIPPING INDUSTRY AND ITS IMPLICATIONS
- THE EU'S SERIOUSNESS IN BLOCKING US EXTRATERRITORIAL SANCTIONS
- IMPORTANT PROVISIONS OF THE BLOCKING STATUTE

"ON 7 AUGUST 2018, BOTH THE FIRST WAVE OF RE-IMPOSED US SECONDARY SANCTIONS, AND THE EU BLOCKING STATUTE TOOK EFFECT, CREATING THE POTENTIAL FOR A SIGNIFICANT CONFLICT…"

In our May 2018 briefing, we explained the process by which the US would re-impose on Iran the secondary sanctions it had lifted as part of the Joint Comprehensive Plan of Action ("JCPOA") process, noting in particular the two-phased approach: those sanctions re-imposed after 6 August 2018, and those scheduled to be re-imposed after 4 November 2018. We further explained how the EU had launched a formal process to re-activate its "Blocking Statute" (Council Regulation (EC) No 2271/96).

On 7 August 2018, both the first wave of re-imposed US secondary sanctions, and the EU Blocking Statute took effect, creating the potential for a significant conflict: how to comply with two incompatible laws at the same time? Compliance with US law might mean infringing EU law, and vice-versa.

This briefing examines how the conflict arises for the shipping industry and its implications.

Uncharted waters

The US policy on Iran sanctions re-imposes the sanctions lifted as part of the JCPOA process,[1] in a changed international context.

[1] Joint Comprehensive Plan of Action, text available at: https://www.state.gov/e/eb/tfs/spi/iran/jcpoa/ and https://eeas.europa.eu/headquarters/headquarters-homepage_en/32286/Nuclear%20Agreement

Before the JCPOA, there was a strong international common interest, at least between the US and the EU, on dealing with Iran, reflected in stringent restrictions imposed by both on doing business with the latter. The US authorities' rigorous enforcement against non-US financial institutions' compliance failures drove a strong compliance culture, evident from sanction clauses which have become standardised in charters and ship financing. Sanction clauses have been included to remove financial institutions from Iran-related risk.

Concern among financial institutions about potential liability for facilitating breach of US sanctions sometimes led to clauses which required compliance by shipping companies with US sanctions without regard to whether said company was a US person and without distinguishing between sanctions which had extra-territorial effect and those which did not.

"WITH THE US RE-IMPOSITION OF SECONDARY SANCTIONS, EU PARTIES WITH US EXPOSURE WILL HAVE TO WIND DOWN OIL TRADING…"

After the JCPOA, some relaxation occurred, for example, to allow for some trading in Iranian oil, but by and large, and perhaps mindful of the risk of sanctions "snap-back", international banks and insurers have not rushed back into doing business with Iran.

With the US re-imposition of secondary sanctions, EU parties with US exposure will have to wind down oil trading (except to the extent that the US issues waivers permitting some level of ongoing oil trading). Without the Blocking Statute, the industry might otherwise expect banks and insurers' risk aversion to remain unchanged, or even heightened.

The Blocking Statute changes the game. While the US has unilaterally withdrawn from the JCPOA, the EU has reaffirmed its commitment to the deal so long as Iran continues to abide by its obligations. To support its official commitment, the EU has amended the Blocking Statute to include the updated extraterritorial Iran sanctions. It has taken a further step of introducing an Implementing Regulation (Commission Implementing Regulation (EU) 2018/1101 of 3 August 2018)[2] which explains how parties can apply for EU authorisation to comply with US sanctions. It has issued a guidance note with Q&A[3] and a joint statement of regret at the US position.[4] The EU thus indicates it is serious about blocking US extraterritorial sanctions, just as the US indicates it is serious about blocking non-US companies from doing business with Iran.

"THE EU INDICATES IT IS SERIOUS ABOUT BLOCKING US EXTRATERRITORIAL SANCTIONS, JUST AS THE US INDICATES IT IS SERIOUS ABOUT BLOCKING NON-US COMPANIES DOING BUSINESS WITH IRAN."

As noted above, the shipping industry has substantial experience of complying with US sanctions (mainly owing to the dominance of US dollar financing of the industry), and although compliance can be a blunt instrument (in the sense of sometimes chilling transactions that may be lawful) it has the advantage of clarity. The Blocking Statute challenges that clarity, and thereby the industry enters uncharted waters. In effect, the US, and more particularly the EU authorities, have privatised a public international dispute.

[2] See: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018R1101&from=EN
[3] See: http://europa.eu/rapid/press-release_MEMO-18-4786_en.htm
[4] See: https://eeas.europa.eu/headquarters/headquarters-homepage/49141/joint-statement-re-imposition-us-sanctions-due-its-withdrawal-joint-comprehensive-plan-action_en

The Blocking Statute creates a conflict

The conflict between sanctions and blocking laws is not new. German law has long had an anti-boycott rule, albeit operating in a different manner to the Blocking Statute.[5] What changes now is the scale of the conflict created by the Blocking Statute.

The Blocking Statute directly applies to:

- Natural persons who are nationals of an EU Member State and resident in the EU;
- Legal persons incorporated in the EU;
- Natural or legal persons established outside the EU but controlled by nationals of EU Member States, and shipping companies established outside the EU where they are controlled by EU nationals and where the vessels are flagged in the same EU Member State;
- Other natural persons resident in the EU unless that person is in the country of which he is a national; and
- Any other natural person within the EU, including its territorial waters and air space, and in any aircraft or on any vessel under the jurisdiction or control of a Member State, and acting in a professional capacity.

"IN EFFECT, THE US AND MORE PARTICULARLY THE EU AUTHORITIES HAVE PRIVATISED A PUBLIC INTERNATIONAL DISPUTE."

The Blocking Statute has a number of important provisions:

- **Information provision**: Article 2 requires any person[6] whose economic and/or financial interests are affected (directly or indirectly) to inform the European Commission within 30 days of obtaining the information relating to such effects. Such a person may then be required to supply further information. Notably, the UK implementing legislation for the Blocking Statute[7] criminalises a breach of this Article 2.[8]
- **Non-compliance with stated laws**: Article 5, first paragraph, prohibits compliance – whether directly or through a subsidiary or other intermediary, and whether actively or by deliberate omission – with any requirement or prohibition, including requests of foreign courts, based on or resulting, directly or indirectly, from the specified foreign laws. Again, UK implementing rules criminalise a breach of Article 5, first paragraph. Note, however, that Article 5, second paragraph, establishes the principle of authorising a person to comply (fully or partially) with the foreign laws, based on meeting what appears a stringent "serious damage" test, which is further explained with indicative criteria in Article 4 of the Implementing Regulation.

From the Blocking Statute emerge several problems:

1. It is not clear how far the Article 2 obligation extends and in particular, what is included in the concept of "economic and/or financial interests". Do these cover only existing business, evidenced by contracts and money flow? Do they extend to contemplated business – negotiations, binding or partially binding Heads of

[5] Section 7 of the Aussenwirtschaftsverordnung (Foreign Trade Ordinance).

[6] Where this is a legal person i.e. a company, the obligation attaches to its directors, managers and other persons with management responsibilities.

[7] SI 1996 No 3171, see: http://www.legislation.gov.uk/uksi/1996/3171/made/data.pdf

[8] Section 2: "any person…who commits a breach of Article 2 … and any director, manager or other person with management responsibilities to whom the obligation in the first paragraph of Article 2 of that Regulation applies who commits a breach of that paragraph shall be guilty of an offence and liable- (a) on conviction on indictment, to a fine; (b) on summary conviction, to a fine not exceeding the statutory maximum.

Terms? Could they extend to business development – meeting counterparties, drawing up business plans – relating to future Iran business?
2. Given the lack of clarity over how far the Article 2 obligation extends, is it reasonable to expect EU Member States to bring enforcement action?
3. With the Article 5 "do not comply" obligation, how is a Member State enforcement authority to prove that a company choosing not to do business with Iran did so in breach of Article 5, as opposed to other reasons which the authority may consider legitimate? Is the test in Article 5 that one of the reasons the company chose not to do business with Iran was to comply with US extra-territorial sanctions, or must it be that its only plausible reason is to comply with such sanctions?
4. In any case, how is the obligation in Article 5 to be reconciled with the EU's own Q&A: "Does the Blocking Statute oblige EU operators to do business with Iran or Cuba? How are they expected to position themselves between the listed extra-territorial legislation and the Blocking Statute"? The answer given is puzzling:

"…COMPLIANCE WITH US SANCTIONS LAW WILL CONTINUE TO BE REQUIRED BY FINANCIERS AND – AS A CONSEQUENCE – THE WIDER SHIPPING INDUSTRY."

"EU operators are free to conduct their business as they see fit in accordance with EU 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 Statutes is exactly to ensure that such business decisions remain free, i.e., not forced upon EU operators by the listed extraterritorial legislation, which the Union law does not recognise as applicable to them."[9]

If this were true, it is difficult to foresee a successful enforcement against an operator since the authority would have to prove – and then enforce against – it on the basis that its decision not to do business in Iran was "not free." This implies a nuanced assessment of an operator's motives which would need to be founded on justiciable principles. Put another way, US sanctions law prohibits defined activities; the Blocking Statute in a sense prohibits "non-activity" which will in many cases be harder to prove.

5. A curious feature of the regime is that the enforcement and penalties are subject to EU Member State national law – with the likelihood of a variety of approaches and jeopardy to breaching the same law, depending on which Member State has jurisdiction – while the system for obtaining authorisation to avoid abiding by the Blocking Statute is reserved to the European Commission.
6. The Authorisation procedure in Article 4 of the Implementing Regulation lists thirteen non-cumulative criteria for assessing whether an economic operator would suffer "serious damage" as a result of abiding by the Blocking Statute. While such detail is helpful at one level, with no precedent or further guidance available it will be difficult for operators to gauge in advance whether an application for authorisation will be granted.
7. The Q&A asks directly whether Member States are obliged to prosecute any possible breaches of the Blocking Statute, to which the answer given is that Member States' authorities are *responsible* for implementing it, including for adopting and implementing effective, proportionate and dissuasive penalties in their legal systems for breach. It also states, "*It is also for Member States to ensure*

[9] Guidance Note Questions and Answers: adoption of update of the Blocking Statute (2018/C 277 I/03) question 5

that the Blocking Statute regime is enforced, including through the application of penalties, where needed and appropriate, in accordance with their national procedures."[10] It does not, however, answer the question of whether a Member State is obliged to enforce, only that they are responsible for enforcing where needed and appropriate. This is echoed in the UK implementing regulations, which state, "*No proceedings for an offence…shall be instituted in England, Wales or Northern Ireland except by the Secretary of State or with the consent of the Attorney General or, as the case may be, the Attorney General for Northern Ireland*"[11] which leaves plenty of scope for prosecutorial discretion.

8. If the public enforcement position is unclear, the private enforcement position is no clearer. An infringement of the Blocking Statute would in UK law be a breach of an operator's statutory duty, opening up the possibility of a private action in damages.[12]

"…THE BLOCKING STATUTE – FOR ALL THE QUESTIONS IT RAISES – IS DIRECTLY APPLICABLE EU LAW WHICH IS BACKED, IN PRINCIPLE, BY AN ENFORCEMENT AND AUTHORISATION REGIME. IT CANNOT BE IGNORED OR DISMISSED."

Concerns of the shipping industry

The shipping industry relies primarily on US dollar-denominated transactions. In addition, and as stated above, banks and insurers operating in the shipping sector have been understandably cautious about Iran business since before the JCPOA. The default position, therefore, is that compliance with US sanctions law will continue to be required by financiers and – as a consequence – the wider shipping industry.

Against that, the Blocking Statute – for all the questions it raises – is directly applicable EU law which is backed, in principle, by an enforcement and authorisation regime. It cannot be ignored or dismissed.

The following approach to examining this conflict is suggested, assuming the relevant parties are within the potential jurisdictional scope of both US sanctions and the Blocking Statute. First, do you have good reasons not to do business with Iran other than compliance with US law? If yes, a case might be made that compliance with US law was incidental to a business decision. As a compliance matter, you should document these reasons contemporaneously with the decision. Second, would non-compliance with US law cause serious harm according to the Article 4 Implementing Regulation criteria? If yes, consider applying to the European Commission for authorisation, but note the risk of being denied authorisation, proceeding to comply with US law anyway, and then facing national enforcement action (public or private) for breach of the Blocking Statute. Thirdly, in any case, having a detailed compliance paper trail considering both sides of the conflict and the steps you take to mitigate risks on both sides will assist in any dealings with authorities.

Conclusion

Shipping companies, especially - but not only - those which are bound by the EU Blocking Statute, who were doing or contemplating doing business with Iran before the snap-back of US sanctions, will need in the first instance to consider carefully their own commercial and legal positions and also the terms of the restrictions in their financing documents, charter parties and not least insurance documents. Ship financiers who are bound by the EU Blocking Statute who have customers in that

[10] Q&A number 10.
[11] Article 2(3) of SI 1996/3171.
[12] Note, despite Brexit, the UK regulation SI 1996/3171 is set to continue in UK law under section 2 of the European Union (Withdrawal) Act 2018.

category will need to look closely at the sanctions provisions in their documents. There are thus difficult and immediate issues to address for some shipping companies and their financiers. There are also issues for the industry generally about how financing documents, charter parties and insurance documents are now to be written in light of this difficult development. Whilst there are no easy or immediate answers, the possibly unique seriousness of the issue means that it is to be hoped that some industry consensus quickly emerges.

The industry will need to keep a close eye on developments, particularly concerning the potential enforcement of the Blocking Statute. It is not known yet how seriously Member States will take their obligations to enforce in the current international diplomatic context, or whether the law is adequately clear to permit effective enforcement or authorisation.

In appropriately clear and strongly-evidenced cases, applying for authorisation would provide a degree of legal certainty to operators while also testing the law, but equally, seeking authorisation in every case on a fail-safe basis may be counter-productive.

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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