Court of Justice of the European Union issues its first decision regarding the right of EU entities to terminate contracts in order to comply with U.S. sanctions laws

On December 21, 2021, the Court of Justice of the European Union ("CJEU") issued a Judgment in Bank Melli Iran v. Telekom Deutschland, Case C-124/20,[1] in which the CJEU provided its first interpretation of the EU Blocking Statute (the "Statute").[2]

The Statute, enacted in 1996, is designed to counter the extraterritorial effect of specific U.S. sanctions laws directed against Cuba, Libya and Iran.[3] See Curtis Client Alert, EU Response to revived U.S. Sanctions against Iran.[4] Article 5 of the Statute prohibits compliance (affirmatively or by omission), with any requirement or prohibition contained in specified U.S. sanctions laws. Under the Statute, the European Commission may authorize an EU person to comply, fully or in part, with the sanctions laws, if violation would result in "serious damage" to the interests of the EU person or the EU.[5] A party (whether or not an EU person) to a contract that has been terminated by an EU

[1] Judgment of the Court (Grand Chamber) in Case C-124/20, *available at*: https://curia.europa.eu/juris/document/document.jsf?text=&docid=251507&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=2732493.

[2] 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 (OJ L 309, 29.11.1996, p.1), as amended, also known as "EU Blocking Statute," *available at*: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A01996R2271-20180807.

[3] The following acts and regulations are listed in the Annex to the 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 (OJ L 309, 29.11.1996, p.1): National Defense Authorization Act for Fiscal Year 1993, Title XVII; Cuban Democracy Act 1992, sections 1704 and 1706; Cuban Liberty and Democratic Solidarity Act of 1996; Iran Sanctions Act of 1996; Iran Freedom and Counter-Proliferation Act of 2012; National Defense Authorization Act for Fiscal Year 2012; Iran Threat Reduction and Syria Human Rights Act of 2012; Iranian Transactions and Sanctions Regulations.

[4] Available at https://d20qsj1r5k97qe.cloudfront.net/news-attachments/EU-Response-to-Revived-U.S.-Sanctions-Against-Iran.pdf?mtime=20191009160254&focal=none.

[5] The second paragraph of Article 5 of the Statute provides: "Persons may be authorized, in accordance with the procedures provided in Articles 7 and 8, to comply fully or partially to the extent that non-compliance would seriously damage their interests or those of the Community. The criteria for the application of this provision shall be established in accordance with the procedure set out in Article 8. When there is sufficient evidence that non-compliance would cause serious damage to a natural or legal person, the Commission shall expeditiously submit to the committee referred to in Article 8 a draft of the appropriate measures to be taken under the terms of the Regulation."

counterparty, under circumstances that indicate an intent to comply with U.S. sanctions laws, may bring an action in a competent forum seeking annulment of the termination.[6]

A. Background of the Case

In 2020, Telekom Deutschland terminated its contracts for the provision in Germany of telecom services to Bank Melli, a company incorporated under the laws of Iran, apparently out of fear of possible repercussions to Telekom Deutschland under U.S. sanctions laws. The decision to terminate was made following the withdrawal of the U.S. from the JCPOA in January 2018, and the ensuing re-imposition of secondary sanctions against Iran, which affected persons on the SDN list, including Bank Melli.[7] As a consequence of the re-imposition of secondary sanctions on Iran, Telekom Deutschland, a non-U.S. person, faced possible punishment by the U.S. government for transacting with an SDN such as Bank Melli, through exclusion from various aspects of the U.S. economic system.

B. The Litigation in Germany

On November 16, 2018, Telekom Deutschland notified Bank Melli of the termination of all of its contracts, effective immediately. In interim proceedings brought by Bank Melli before the Regional Court of Hamburg (Landgericht Hamburg), the court, in a judgment dated November 28, 2018, ordered Telekom Deutschland to perform the contracts until the contractual terms allowed notice of termination to be served. On December 11, 2018, Telekom Deutschland notified Bank Melli of the termination of the contracts as of the earliest date possible under the terms of the contracts. Bank Melli brought an action before the Regional Court of Hamburg, demanding a judgment that would require Telekom Deutschland to continue providing services under the contracts. The Regional Court denied the application, holding that termination of the contracts was proper under Article 5 of the Statute. Bank Melli appealed from the judgment to the Hanseatic Higher Regional Court of Hamburg (Hanseatisches Oberlandesgericht). That court stayed proceedings, and referred questions concerning the interpretation of Article 5 of the Statute to the CJEU for a preliminary ruling.

C. The Judgment of the CJEU

In a Judgment issued December 21, 2021 (the "Judgment"), the CJEU issued a preliminary ruling, which included the following determinations:

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[6] The right to challenge the termination is provided for in the national law of individual EU Member States. In addition, Article 5 of the Statute prohibits to "comply, 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." *Id*.

[7] https://home.treasury.gov/news/press-releases/sm541 (Nov. 5, 2018).

- The Statute's prohibition against compliance with specific U.S. sanctions laws is effective even in the absence of a court judgment or order, or administrative order, requiring compliance with such sanctions. The Statute prohibits the unilateral termination of a contract by an EU person if the purpose is to comply with the specified U.S. sanctions laws.

- An EU person who is a party to a contract with an SDN is not precluded from terminating the contract without giving reasons; however, in civil proceedings instituted by the counterparty, the EU party bears the burden of proving that the termination was not for the purpose of complying with the U.S. sanctions laws.

- A national court can order annulment of the termination of a contract if it finds that the purpose of termination was to comply with the U.S. sanctions laws, provided the annulment of termination does not impose a disproportionate impact on the EU party, taking into account the objectives of the Statute and the broader interests of the EU. Proportionality must also take into account the probability that the EU party may suffer economic loss, as well as the extent of that loss, if the termination is annulled.

D. Analysis

The likely consequence of the Judgment is that it will make it more difficult for EU parties to terminate their contracts with SDNs, or with non-SDNs that implicate U.S. sanctions laws, regardless of whether the actual purpose of termination is to comply with U.S. sanctions laws. Any such termination will likely be viewed with suspicion, and could lead to litigation and enforcement activity. As the EU party bears the burden of proving a non-prohibited purpose, any EU party contemplating such termination would be well-advised to develop an evidentiary dossier that documents bona fide reasons for termination, unrelated to U.S. sanctions concerns.

If termination is indeed for the purpose of compliance with U.S. sanctions laws, or if the record is unclear in that regard, and a court finds that the EU party has not met its burden of proof, the EU party will have to rely on the proportionality defense. This will, of course, be very case-specific.

As a protective measure, EU parties might consider including contractual language to the effect that in the event a counterparty becomes subject to U.S. or other sanctions, the contract will automatically terminate. A UK court has held that such a provision does not

constitute compliance with U.S. sanctions laws in derogation of the Statute, but rather allows the contract to operate under its own terms.[8]

Finally, because the UK has grandfathered the Statute,[9] the CJEU judgment, albeit not binding, may well be regarded as persuasive in the English courts.

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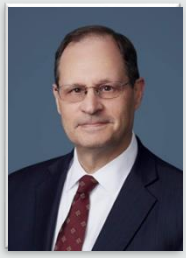

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[8] See Mamancochet Mining Ltd v Aegis Managing Agency Ltd & Ors [2018] EWHC 2643 (Comm).
[9] See the Protecting against the Effects of the Extraterritorial Application of Third Country Legislation (Amendment) (EU Exit) Regulations 2019.