

# An Assessment of the Efforts to Mitigate the Impact of US Secondary Sanctions: The EU Blocking Statute and INSTEX

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## **From convergence to divergence: US withdrawal from the JCPOA**

With the conclusion of the Joint Comprehensive Plan of Action (JCPOA)<sup>1</sup> and the unanimously passed United Nations Security Council resolution 2231 (2015), which endorsed the JCPOA,<sup>2</sup> both the United States and the European Union (EU) demonstrated a convergence of their strategic approaches towards limiting the Iranian nuclear program. As a consequence, the American and European sanctions architecture towards Iran worked in parallel and affected both jurisdictions in a harmonized manner.<sup>3</sup>

However, while the primary emphasis of the JCPOA concentrated on limiting the size and capabilities of the Iranian nuclear program, in 2017 the incoming Trump administration criticized the various provisions of the agreement as insufficient<sup>4</sup> and emphasized that the Iranian missile program as well as Iran's regional posture areas should also be addressed.<sup>5</sup> Soon after, in May 2018,<sup>6</sup> it decided to unilaterally leave the JCPOA and reinstate those sanctions against Iran that the US government had lifted as part of the agreement.<sup>7</sup> The sanctions were reactivated in two steps, in August<sup>8</sup> and November 2018.<sup>9</sup> Since that time, the US government has continued to regularly impose additional sanctions against Iran.<sup>10</sup> Since it did not lift significant primary sanctions<sup>11</sup>; the US sanctions reimposed in 2018 were primarily secondary sanctions<sup>12</sup> and therefore impacted private sector stakeholders in the EU rather than in the US.<sup>13</sup>

In contrast, the EU announced that it would work to preserve the agreement.<sup>14</sup> This extended to maintaining legitimate economic ties with Iran.<sup>15</sup> In order to

shield European companies from the impact of secondary US sanctions, the EU decided on a range of measures<sup>16</sup>; the two central ones – the EU Blocking Statute<sup>17</sup> and the Instrument for Support of Trade Exchanges (INSTEX) – are the focus of this article.<sup>18</sup> It will be argued that due to administrative as well as operational reasons neither measure was able to effectively fulfill its stated purpose. The article will conclude with a few key lessons learned during the past two years. Despite the declared wish of the incoming Biden administration to return to the JCPOA,<sup>19</sup> and with it hope for a redeveloping convergence of the two sanctions architectures concerning Iran, future divergence on sanctions-related issues between the US and the EU cannot be excluded. Therefore, an impact assessment of these instruments and a short analysis of their legal and operational weaknesses seem useful.

## **Countermeasures taken by the European Union**

### ***1. The Blocking Statute***

The Blocking Statute is a rarely used legal device<sup>20</sup> originally introduced by the EU in 1996 to shield European companies from the “extraterritorial effect of third-country laws.”<sup>21</sup> The statute essentially has four main functions: 1) it requires European companies not to comply with those US sanctions outlined in the statute (Article 5); 2) it nullifies foreign court decisions against European companies as they relate to the third-country sanctions outlined in the statute (Article 4); 3) it allows companies to recover damages imposed by foreign regulators in EU courts (through seizures of respective third-country assets in Europe) (Article 6); and 4) it requires EU companies to document their business dealings with Iran (in this case) and any financial damages that may be incurred by the extraterritorial application of third-country sanctions (Article 2).<sup>22</sup>

Although these provisions appear fairly strong in a legal sense, their application does not seem to have resulted in the desired effect. For example, EU trade with Iran was halved between 2018 and 2020,<sup>23</sup> and many European companies decided to end their business in Iran.<sup>24</sup> Furthermore, to date, there have only been a handful of enforcement actions by EU member states, some done under the version of the statute prior to 2018,<sup>25</sup> indicating that the statute was not frequently used.

According to critics, this relates to two major weaknesses of the statute – lack of enforcement and a certain openness in its language. The enforcement

of the provisions of the statute is delegated downwards to EU member states (Article 9) and a reporting requirement to the European Commission only relates to cases in which the statute was enforced (Article 10), rather than, for example, an annual reporting requirement of all member states concerning its enforcement (or lack thereof). This results in enforcement differences, since the individual member states must decide how to implement the statute and set its penalties into their national laws and regulations.<sup>26</sup>

Furthermore, the statute is not a legal instrument to facilitate or encourage trade with Iran, but is intended only to shield European companies from the effects of secondary economic sanctions. Therefore, it is not an active instrument that member states can use but a purely defensive legal measure to which individuals or companies can take recourse<sup>27</sup> if they can show that they have in fact been affected by secondary sanctions.

Furthermore, in its guidance to the Blocking Statute, the EU stated that EU operators would not be required to do business with Iran and could do so “on the basis of their assessment of the economic situation.”<sup>28</sup> This language, of course, enabled companies to indirectly comply with secondary US sanctions by leaving Iran, emphasizing economic rather than compliance reasons for doing so.<sup>29</sup> Indeed, from the onset there was “significant momentum behind European companies leaving Iran.”<sup>30</sup> In this way, a conflict with secondary US sanctions provisions does not arise.

Finally, the effect of the statute is also limited due to the dominance of the US dollar in the international banking system, as European Commission Vice President Valdis Dombrovskis stated already in 2018.<sup>31</sup> In order to enable payments from and to Iran without taking recourse to the international banking system, the EU decided to establish INSTEX.

## ***2. INSTEX***

As part of its initial announcement, the EU indicated that it would work towards facilitating payment mechanisms from and to Iran to counter the effects of secondary sanctions levied by the United States against the Iranian financial system.<sup>32</sup> This led to the creation of INSTEX,<sup>33</sup> which began operating in June 2019.<sup>34</sup> INSTEX is a Paris-based company that is owned by several European countries.<sup>35</sup> Together with its Iranian counterpart, the Special Trade and Finance Instrument (STFI),<sup>36</sup> it represents a closed-loop system where payment claims are mutually settled via forfeiture<sup>37</sup> without

taking recourse to the US dollar and the SWIFT system.<sup>38</sup> INSTEX is currently limited to trade in humanitarian goods.<sup>39</sup> INSTEX-facilitated trade remains within the domain covered by the general licenses issued by the US Office of Foreign Assets Control (OFAC) that allow humanitarian trade with Iran<sup>40</sup> and does not present a conflict with US sanctions provisions. In order to ensure compliance with EU, UK, and UN sanctions provisions against Iran, INSTEX also offers due diligence services to European small- and medium-sized companies concerning their Iranian counterparts.<sup>41</sup>

However, while INSTEX presents a project of “remarkable political ambition”<sup>42</sup> from the EU, the mechanism was not able to reverse the reduction of trade between Iran and Europe. Although INSTEX trading data are not publicly available, the first test transaction was reported only in March 2020,<sup>43</sup> demonstrating the various challenges the new mechanism had to encounter to become functional.<sup>44</sup> These challenges are, first, due diligence and compliance standards, which need to be applied equally both by INSTEX and STFI.<sup>45</sup> Second, STFI is owned by a range of Iranian banks,<sup>46</sup> which creates vulnerabilities as far as the sanctions exposure of these banks to US sanctions is concerned. Furthermore, since trade between Europe and Iran tends to operate with a significant imbalance,<sup>47</sup> INSTEX as a quasi-barter mechanism is unlikely to be able to function on a significant scale as this would require constant cross-border transactions to balance the system. This would be particularly the case if crude oil trade would be facilitated via INSTEX, something that the Iranian side has frequently demanded,<sup>48</sup> but was ultimately not included in the INSTEX trade facilitation.<sup>49</sup> In addition, European banks that accept INSTEX-related transactions may be exposed to indirect sanctions risk as such payments, while not originating in Iran, pertain to trade with Iran.<sup>50</sup> Therefore, rather than being able to facilitate new trading connections, INSTEX seems to work best in facilitating the continuation of established business relationships.<sup>51</sup> Finally, with the creation of INSTEX as a separate payment mechanism, the EU runs the risk of encouraging the establishment of other separate payment mechanisms outside the SWIFT system and therefore may contribute to reducing the transparency of the global financial system.<sup>52</sup> Interestingly, while remaining critical of INSTEX,<sup>53</sup> the US administration in 2020 decided to set up its own humanitarian payment channel via Swiss banks.<sup>54</sup>

Therefore, while INSTEX established a new trading mechanism for EU companies with Iran, its structure and operations are necessarily limited by a range of legal and operational challenges. In consequence, this new tool, similarly to the Blocking Statute, while contributing to safeguard some EU trade with Iran ultimately proved largely insufficient in practical terms to maintain significant levels of trade. However, while the Blocking Statute could be improved to better shield EU companies from the effects of extraterritorial secondary sanctions in the future, INSTEX could begin to play an important role in the current situation if the new Biden administration wishes to send political signals to the Iranian side without having to take immediate recourse to sanctions relief.

### **Lessons learned**

The Blocking Statute and the new INSTEX trade facilitation channel were the first efforts of the EU to mitigate the effect of secondary US sanctions, caused by the divergence in the sanctions approach on both sides of the Atlantic towards Iran following the Trump administration's unilateral withdrawal from the JCPOA. This brief article has argued that both mechanisms proved insufficient to reach their stated goal to maintain legitimate European trade with Iran. However, even the relative short experience with both mechanisms allows for a first assessment of their weaknesses, which could be improved should they become necessary again in the future.

The basic challenges for the EU when wishing to mitigate the effect of US secondary sanctions is the importance of the US market for EU companies<sup>55</sup> and the dominance of the US dollar in international trade, including the EU.<sup>56</sup> This demonstrates the importance for EU trade of maintaining convergence in sanctions strategies between the US and the EU. Any potential mitigation measures must be tailored to recognize these limitations and the role the US market plays in the European economy.

As far as the Blocking Statute is concerned, one significant weakness is its decentralized implementation by EU member states, which creates potentially uneven risk environments for companies. Consequently, a more centralized EU sanctions authority, tasked with implementing the statute across the EU and giving guidance to companies, may enhance the statute's impact.<sup>57</sup> Nevertheless, it seems unlikely that the statute will be effective

enough to offset the risk of large US fines for corporations with significant business interests in the US market.<sup>58</sup>

The risk that INSTEX may encourage other economic zones to create their own special-purpose mechanisms and thus reduce transparency within the global financial system remains.<sup>59</sup> INSTEX also demonstrated the challenges of implementing a sanctions-compliant payment mechanism with a jurisdiction that has reduced business transparency.<sup>60</sup> However, given that INSTEX is focused on humanitarian trade, an issue that has gained significantly in relevance due to the global COVID-19 pandemic, it may be a vehicle to quickly increase humanitarian deliveries to Iran through the provision of a loan to Iran to purchase such goods.<sup>61</sup> By using INSTEX and the US-created Swiss Humanitarian Trade Arrangement in parallel, the volume of such trade could be boosted without changing the respective US or EU sanctions environments first. Without the necessity of sanctions relief, this could be a potential opening gambit for the incoming Biden administration in return for Iran beginning to reduce its nuclear activities and returning to compliance with the restrictions outlined in the JCPOA.

## Notes

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- 10 For an overview of all US sanctions against Iran, see <https://home.treasury.gov/policy-issues/financial-sanctions/sanctions-programs-and-country-information/iran-sanctions>
- 11 Primary sanctions are those that “prohibit citizens and companies of the sanctioning country from engaging in certain activities with their counterparts from the sanctioned country,” Moehr, O. (February 6, 2018). Secondary Sanctions: A First Glance, Atlantic Council. <https://www.atlanticcouncil.org/blogs/econographics/ole-moehr-3/>
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- 22 Blocking Statute: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:01996R2271-20140220&from=EN>, Updated annex relating statute to Iran sanctions: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018R1100&from=EN>
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- 25 Walsh, J. (March 31, 2020). The Blocking Statute – Deciphering its Provisions, How to Handle the EU/US Conflict, and Actions to Date, Association of Certified Sanctions Specialists, <https://sanctionsassociation.org/the-blocking-statute-deciphering-its-provisions-how-to-handle-the-eu-us-conflict-and-actions-to-date/> and only one case in which the European Court of Justice has been asked to give an opinion, see HHR, First Reference to the European Court of Justice to Interpret the EU Blocking Statute in the Bank Melli Iran v. Telekom Deutschland GmbH Case, July 1, 2020, <https://www.hugheshubbard.com/news/first-reference-to-the-european-court-of-justice-to-interpret-the-eu-blocking-statute-in-the-bank-melli-iran-v-telekom-deutschland-gmbh-case>
- 26 EU Guidance Document, para. 10, [https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52018XC0807\(01\)&from=EN](https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52018XC0807(01)&from=EN)
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- 32 Implementation of the Joint Comprehensive Plan of Action: Joint Ministerial Statement (September 24, 2018). [https://eeas.europa.eu/headquarters/headquarters-homepage/51036/implementation-joint-comprehensive-plan-action-joint-ministerial-statement\\_en](https://eeas.europa.eu/headquarters/headquarters-homepage/51036/implementation-joint-comprehensive-plan-action-joint-ministerial-statement_en)
- 33 <https://instex-europe.com/about-us>
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- 35 France, Germany, UK, Belgium, Denmark, Netherlands, Norway, Finland, Sweden.
- 36 The name of the company is: شرکت سهامی خاص ساز و کار ویژه تجارت مالی ایران و اروپا, Registration Number: 540240, National ID: 14008285716, <http://www.rrk.ir/News/ShowNews.aspx?Code=14575568>
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- 39 <https://instex-europe.com/about-us>
- 40 Several general licenses have been issued by OFAC for this sector: [https://home.treasury.gov/system/files/126/gl\\_food\\_exports.pdf](https://home.treasury.gov/system/files/126/gl_food_exports.pdf)  
[https://home.treasury.gov/system/files/126/fr79\\_18990.pdf](https://home.treasury.gov/system/files/126/fr79_18990.pdf)  
[https://home.treasury.gov/system/files/126/iran\\_gl8a.pdf](https://home.treasury.gov/system/files/126/iran_gl8a.pdf)
- 41 <https://instex-europe.com/partners>; this is done via its partner, the Due Diligence Help Desk, <https://sanctions-helpdesk.eu>
- 42 Batmanghelidj, E. and Shah, S. (June 2019). Protecting Europe-Iran Trade to Prevent War: A Provisional Assessment of INSTEX, in European Leadership Network and Bourse & Bazaar, p. 8, <https://www.europeanleadershipnetwork.org/wp-content/uploads/2019/06/ELNBB-INSTEX-June-27-2019-ADVANCE-COPY.pdf>
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- 45 Batmanghelidj, E. and Shah, S. Protecting, p. 5.

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<http://www.rrk.ir/News/ShowNews.aspx?Code=14575568>
- 47 <https://ec.europa.eu/trade/policy/countries-and-regions/countries/iran/> (see in particular 2019).
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