Risk of violating US sanctions as a ground for force majeure: A Dutch perspective



At the heart of a recent Dutch court case was the issue as to whether compliance with an agreement to provide inspection activities for pipelines in Iran would breach US secondary sanctions. Eline Mooring, Tim Hesselink and Marc Padberg discuss the judgment.

Companies based in the European Union with interests in the United States have long been presented with difficult choices when it comes to trade with Iran. This uncertainty was heightened after US President Donald Trump removed the US from the Joint Comprehensive Plan of Action ('JCPOA') and reinstated all previously lifted US sanctions. As a response to the reinstated US sanctions, the EU has expanded the scope of the existing Blocking Regulation to include the US reinstated extraterritorial sanctions against Iran.

In a recently published judgment of the Rotterdam District Court, the extraterritorial application of the secondary US sanctions is central. Parties disputed whether compliance with an agreement to provide inspection activities for pipelines in Iran had become impossible as a result of the secondary US sanctions and whether, as a result of these sanctions, *force majeure* could successfully be invoked. Before discussing the (relevant) content of this judgment, the complex legal stalemate between the extra-territorial application of the US sanctions regime and the EU Blocking Regulation is briefly discussed.

Joint Comprehensive Plan of Action

After years of negotiation, the JCPOA entered into force on 16 January 2016. The JCPOA is a nuclear agreement concluded between Iran, the US, Russia, China, France, the United Kingdom, Germany and the EU. The agreement focuses on phasing out the Iranian nuclear programme in exchange for a gradual lifting of the sanctions against Iran imposed by the United Nations, the US and the EU. President Trump unilaterally terminated this agreement on 8 May 2018, thus putting an end to the suspension of the US sanctions against Iran. Following the announcement, the US sanctions have been reinstated within 90 and 180 days respectively. As a result, parties affected by the US sanctions against Iran had limited time left to fulfil their contractual obligations. The remaining signatories to the JCPOA have continued their commitment to the agreement.

Extraterritorial application of US sanctions

As is well understood by readers, the United States has given its sanctions regime a so-called 'extraterritorial application' with the result that secondary sanctions, which US enforcers contend do not require a US nexus, may be imposed on foreign persons directly or indirectly engaged in certain significant transactions relating to sanctioned countries. In other words, even if there is no legal jurisdiction, foreign persons can become subject to US secondary sanctions. While the risk of US enforcement for violations of the secondary sanctions is relatively low, the Office of Foreign Assets Control ('OFAC') has the ability to impose a wide range of penalties. These include

(amongst others) possible limitation on access to or even exclusion from the US financial system. With the most severe measure, a foreign person acting in violation of the secondary sanctions can be placed on the Specially Designated Nationals and Blocked Persons List ('SDN'). As a consequence, all US persons are prohibited from doing businesses with them. It is clear that this constitutes a major risk for companies having a large group of customers or suppliers in the US.

EU Blocking Regulation

Council Regulation (EC) No 2271/96 ('the Blocking Regulation') has been in force in the EU since 1996 and aims to 'protect' EU companies from the extraterritorial application of third-country laws. Initially, the Blocking Regulation was adopted to protect EU operators from the consequences of the US sanctions against Cuba, Iran and Libya. Until 2018, the Blocking Regulation had received little or no attention and few changes had been made. This changed with the withdrawal of the US from the nuclear trade agreement and associated reinstatement of US secondary sanctions. The Blocking Regulation was raised by the EU as the instrument to protect the interests of EU companies doing business with Iran. The updated Blocking Regulation therefore entered into force on 7 August 2018. As a result of this update, the reinstated US sanctions against Iran also fall within the scope of this Regulation.

The Blocking Regulation prohibits EU companies from complying with the foreign legislation listed in the Annex of the Regulation, including the reinstated US sanctions against Iran. The prohibition applies to any form of compliance regardless of whether it occurs directly or indirectly through subsidiaries or intermediaries. The prohibition is therefore of

particular importance for EU companies with establishments in the US. As a result, EU companies with interests in the US face a dilemma. If they comply with the Blocking Regulation, they are at risk of exclusion from the US market; if they comply with the US sanctions, they are in breach of the Blocking Regulation. Companies dealing with a transaction affected by both the EU and the US sanctions regime are unable to comply with both regimes. In light of the global clout of the US sanctions regime, it appears in practice that companies with US interests from a commercial point of view choose to act in accordance with the US sanctions.

But what if parties are faced with a risk of exposure to US sanctions after the conclusion of an agreement? In the case before the District Court of Rotterdam, the question arose as to whether the risk of violation of the secondary sanctions justifies invoking *force majeure*.

The PGP v. Pipe Survey case

This case concerned the execution of an agreement in Iran. An Iranian company, Payesh Gostaran Pishro Ltd. ('PGP') entered into an agreement with the Dutch company Pipe Survey International C.V. ('Pipe Survey') on 5 May 2017 to carry out inspection activities on six pipelines in Iran. Following several postponements of the date on which the inspection activities would be carried out by Pipe Survey, on 5 May 2018 the parties agreed that the inspections would start at the end of August 2018. On 8 May 2018, the US announced the withdrawal from the nuclear trade agreement, as a result of which the US secondary sanctions on Iran would be reinstated. Following this announcement, Pipe Survey suspended its obligations under the agreement on the grounds of *force majeure*. The parties disputed whether Pipe Survey was entitled to invoke *force majeure* on the basis of the US sanctions imposed, thereby suspending its obligation to carry out the inspection activities. Article 15 of the contract reads as follows:

'15. Force Major

Parties shall not be responsible for and shall have no liability in respect of failure or of delay in performance hereunder if such failure or delay is due to any causes which are not reasonably within the control of Pipesurvey International, including in particular but without limitation strikes, lock-outs, wars, earthquakes, storms, fires, floods, explosions, hurricanes, civil disturbance, terrorism, governmental infringement.'

While the parties did not specify in the agreement how the term 'governmental infringement' was to be understood, the court interpreted this term to also include the US sanctions regime. However, according to the court, this did not automatically imply that Pipe Survey could invoke *force majeure*, since the other requirements of Article 15 also had to be met.

In paragraph 4.18 of the judgment, the court addresses the secondary US sanctions: 'The sanctions that divide the parties in this dispute are the so-called US secondary sanctions. These sanctions prohibit non-US persons or companies from exporting goods of US origin (goods consisting for more than 10% of US components, software or technology) to Iran.'

From the judgment, it appears that the court is relying on the definition found in the Iran Handbook of the Dutch Ministry of Foreign Affairs (in Dutch: '*Handboek Iran*'), to which the court refers in an earlier part of the judgment and which provides for a similar interpretation of the secondary US sanctions. It goes beyond the scope of this article to extensively discuss the correctness of the court's interpretation of the concept of secondary US sanctions, but in any case it seems that the court ignores the meaning of the Export Administration Regulation ('EAR'): nonetheless, Pipe Survey argues that more than 10% of the inspection tools used during the inspection activities consists of US origin parts, and while the question as to whether such parts would be subject to the EAR cannot be concluded from this judgment, the court agrees with Pipe Survey that US secondary sanctions would apply to Pipe Survey's activities in Iran under the agreement.

BY REFERRING TO THE EU BLOCKING REGULATION, THE COURT REMARKED THAT THE EXTRATERRITORIAL EFFECT OF THE US SANCTIONS REGIME IS NOT RECOGNISED IN THE EU.

Pipe Survey argues that, if it decides to export US origin goods in violation of the US sanctions, it faces a significant risk that it will no longer be able to obtain parts from the US or carry out business activities in the US. At the same time, Pipe Survey points to a possible future collaboration with a US partner and the director of Pipe Survey issues concerns about travelling to the US in a private capacity.

The court first considered that there is no injunction or measure by the EU government prohibiting the performance of the agreement by Pipe Survey. There was therefore no legal impossibility of performance of the agreement. By referring to the EU Blocking Regulation, the court remarked that the extraterritorial effect of the US sanctions regime is not recognised in the EU. It was true that had Pipe Survey executed the contract, it may have breached the secondary sanctions (which could have led to the imposition of sanctions against Pipe Survey itself) and thus probable that Pipe Survey would no longer want or be able to carry out business activities in the United States. Nevertheless, the court ruled that executing the contract would not have been a 'legal impossibility' which would amount to *force majeure*.

Secondly, the court considered whether there was a 'practical impossibility' which would justify invoking *force majeure*. In this regard, the court took into account the following four considerations:

1. The share of Pipe Survey's business in the US is so low (14%) that it is hard to imagine that its loss would lead to such financial difficulties that the company's continued existence would be endangered.
2. A possible future collaboration with a US partner does not justify a breach of the agreement.
3. Doing business with Iran was never risk-free, even before the US sanctions were reinstated (certainly not in relation to the US).
4. The inability of a director to visit the US because of exposure to enforcement of such sanctions does not justify invoking *force majeure*.

Thus, the court found that Pipe Survey's continued existence would not be endangered were it to perform the agreement, nor do there seem to be other risks leading to insurmountable consequences for Pipe Survey. This means the court cannot conclude that performance of the agreement must be regarded as so extremely difficult for Pipe Survey that it would amount to a practical impossibility.

This is in line with a Dutch judgment from 2019, in which the District Court of the Hague ordered the Dutch software company Exact to continue to perform its contractual obligations despite the risk of violating US sanctions. Exact had concluded an agreement with the Curaçao-based company PAM International, under which PAM would distribute software supplied by Exact to companies in Cuba. Exact ceased its performance under the agreement when it was acquired by KKR, a US-based investment company. Exact argued that it was legally obliged to terminate the agreement following

the acquisition and that the circumstances amounted to *force majeure*. The court nonetheless found that the fact that Exact and its shareholders may be exposed to criminal and financial liability as a result of the continuation of the agreement represents a risk that is for them to bear. The court further noted that Exact may have breached the Blocking Regulation by terminating the agreement.

Why is this relevant?

This is – as far as we know – the first time that a Dutch court has ruled on the interpretation of the secondary US sanctions regime. Although the court in this case concludes that invoking *force majeure* was not justified, it appears not to exclude the possibility that the risk of violation of the secondary US sanctions could under circumstances justify invoking *force majeure*.

While the extraterritorial effect of the US sanctions legislation is not recognised by the EU, the court's judgment suggests that there may be circumstances in which execution of a contract in violation of secondary sanctions becomes a *practical* impossibility that justifies invoking *force majeure*. Facts and circumstances would have to be established that demonstrate that a breach of the US sanctions would endanger the very existence of the company or otherwise involve risks leading to insurmountable consequences. A single 14% share of total US sales, possible future cooperation with a US partner, or concerns about the inability of a director to visit the US are in any event not sufficient.

Finally, parties are advised to specify the circumstances that may lead to *force majeure* in the *force majeure* clause, to avoid any confusion. The fact that the court assumes that 'governmental infringement' can also include US sanctions without this being specifically mentioned in the *force majeure* clause, does not mean that this will always be the case. In this particular case, this point was not in dispute between the parties. The parties would therefore be well advised to specifically mention the US sanctions in the *force majeure* clause.

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