POSITION PAPER

BUSINESSEUROPE

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Recommendations to strengthen the EU foreign economic diplomacy in the area of sanctions *

KEY MESSAGES

1. Business opposes the weaponisation of the sanctions policy and the use of such measures to pursue economic interests. Sanctions are designed specifically to enforce the respect of international law, to counter fundamental threats to peace and stability and the protection of human rights and must be limited to these core purposes.

2. We welcome the political attention to this matter and support a more assertive approach by the EU to protect its sovereignty in economic diplomacy. Unilateral measures that risk escalation with third countries should remain an option of last resort and multilateral approaches should be actively sought where possible. Especially with the USA as our traditional ally, the main aim must remain to achieve alignment on sanctions policies and implementation. A close cooperation regarding sanctions should also be established with the UK as part of the future relation.

3. The aim must be to deter harmful action by third countries and, if necessary, to increase the costs for such harmful action. To do so, the toolbox needs to be better equipped with well-targeted, non-discriminatory, and well workable and implementable solutions. In the current absence of an effective mechanism, EU companies are caught between a rock and a hard place.

4. The EU, together with its allies, should take international leadership on this issue leveraging on its economic and political weight. The EU should insist on a multilateral strategy as this will increase the political strength of the argument.

INTRODUCTION

Recently, the independence of the EU foreign economic policy has been increasingly debated not the least due to the extraterritorial impact of third-party sanction regimes, namely those by the United States. Notably this was the case with the implementation of sanctions on Cuba through the Helms-Burton Act in May 2019; the reintroduction of sanctions on Iran after the withdrawal of the USA from the Joint Comprehensive Plan of Action (JCPOA) in May 2018; the enactment of the “Countering America’s Adversaries

* The views and positions in this paper are not supported by the Polish Confederation Lewiatan and the Lithuanian Confederation of Industrialists (LPK).

through Sanctions ACT" (CAATSA), which resulted also in imposing sanctions against the aluminium company Rusal in April 2018, which created major bottlenecks for the EU aluminium market; as well as, most recently, the sanctions under the "Protecting Europe's Energy Security Clarification Act", targeting Russia and impacting two big European energy projects. Notwithstanding the previously long-standing coordinated trans-Atlantic approach to sanctions and the efforts of the European institutions, these measures were imposed unilaterally and were not coordinated with the European Union. Also, they have a negative impact on European companies' interests and undermine the EU's capability to pursue its foreign economic policy interests independently.

BusinessEurope welcomes the initiative of the European Commission to work on the broader issue of European economic and financial sovereignty, that should be based on the ongoing work on deepening the Economic and Monetary Union. Concerning sanctions, we welcome measures that aim to strengthen the EU's assertiveness and resilience both regarding its own and third-country sanction regimes and to modernise the tools at hand, such as the Blocking Statute Regulation.

BusinessEurope proposes measures in five kea areas with a view to delivering a well-targeted and workable sanctions policy able to respond to today's economic and business realities also for European companies. The paper also includes some proposals in the area of payments and the role of the euro, which should be integrated in the overall work on the Economic and Monetary Union.

RECOMMENDATIONS

International outreach

- Take a holistic approach on US extraterritoriality, not only on sanctions but also on other issues (anti-corruption, anti-money laundering, export controls, etc.) and ensure a united approach by member states. In principle, action at the European level should be privileged in order to maximise leverage in negotiations with third countries.
- In order to act unitedly on this and other issues a move to qualified majority voting (QMV) in foreign policy matters should be prepared and envisaged for the future.
- Include this issue also in the framework of European economic diplomacy and raise the issue of extraterritorial effects of sanctions at multilateral level in the relevant fora (G7, WTO) as well was bilaterally.
- Agreement should be sought on an international level (e.g. G20, G7, IMF, GAFI, BIS) that goods and services which are systemically necessary for the functioning of our economies to conduct legitimate trade, in particular certain financial transactions or platforms and critical infrastructure, should in principle remain independent from political action (exceptions can be considered e.g. for sanctions by the UN Security Council).

- Keep engaging with international allies to try and coordinate sanctions policies with a view to supporting common foreign policy goals but remain firm on EU businesses' right to engage with or disengage from foreign partners while respecting all applicable European legislation. Towards third countries this right must be protected with the appropriate juridical tools under EU or member state jurisdictions.
- Attentively observe the measures other countries are taking in order to avoid dollar-dominated channels and consider whether certain elements of these approaches could inspire the EU's own measures.

Ensure workability of third-country sanctions with extraterritorial effect

- In cases where European operators are facing a catch-22 situation of conflicting laws impacting their operations in different countries, European companies must remain free to disengage from operations in countries affected by sanctions based on their risk assessment.
- Bring into full operation the special purpose vehicle (SPV) "Instrument in Support of Trade Exchanges" (INSTEX) to facilitate new operations in sectors that are not subject to extraterritorial sanctions (e.g. humanitarian trade) and to build trust in the system to ensure that it can be used not only for trade with Iran but also for other countries, and gradually extend the scope of products that can be processed as part of "legitimate trade". The aim should be also to extend the membership to build political resilience and to ensure a very tight exchange of information on activities with and between EU member states. To this end, the European Commission should be closely involved in the operation but BusinessEurope would discourage a direct integration of this mechanism in EU governance structures due to political risks.
- In order to build trust in this new tool among companies, increased exchange with stakeholders would be beneficial to clarify its functioning. Specifically, increased transparency on transactions carried out by INSTEX as well as the legal obligations for companies regarding compliance and due diligence would be welcomed. Untransparent processes feed distrust among economic operators, increase compliance risks and disincentivise the use of INSTEX in the longer run.
- Even with INSTEX in place, many operators could encounter issues when finalising legitimate operations as certain service providers and systems remain exposed to the risk of unilateral sanctions. For such cases, it should be explored how legal clarifications and mechanisms could contribute to enhance the protection of companies.
- In the specific case of the existing US sanctions on Iran, where banks are subject to US secondary sanctions, the EU should ensure that in order to allow "legitimate trade" to continue, Iranian counterparts that are necessary to complete the financial transactions remain connected to SWIFT.
- Establish an effective channel for dialogue between the relevant EU and US institutions to coordinate the application of sanctions and to develop guidelines to

help companies and financial services providers on both sides to comply with the applicable sanction regimes. This should be coordinated by a specific body as described below.

The Blocking Statute Regulation

- In its current state, the Blocking Statute Regulation confronts many economic operators with a conflict of laws, in which US law often prevails. In many cases the Blocking Statute Regulation seems to fall short of achieving its objective. Any modifications with a view to strengthening the regulation must be done in a way that effectively tackles the risk of conflict of laws for companies and, by doing so, takes the diversity of sectors and their exposure to foreign legislation into full consideration.
- Further clarify the Regulation (EC) 2271/96 ("Blocking Statute Regulation") to make the procedures clearer for entities and increase its effectiveness. To this end:
    - The regulation should clarify the role and responsibilities of both member state authorities and the European Commission in the process and ensure coherent information and implementation across the EU.
    - A simultaneous modification of Articles 5 and 6 could increase the protective legal effect of the regulation. Careful consideration must be given to focusing the reform to defend European sovereignty and not to enter into an escalation or confrontation with the USA. Sectoral interests must be carefully balanced and the overall aim to reduce the risk of conflict of laws must be at the centre of any reform.
    - <u>Article 5 (compliance prohibition):</u>
        - The strategy to shield companies from receiving notifications does not guarantee that US courts will not convict companies even *in absentia*. Not being able to defend their interests in court can be particularly harmful for companies that own assets in the USA. In most cases, the currently discussed options of *amicus curiae* or the option to limit the defence to the motion to dismiss for lack of jurisdiction or constitutionality (example of the Helms Burton Act) are rather limited. In case of litigation, European companies should be able to protect their interests effectively and the Blocking Statute must provide a supportive framework.
        - Clarify what obligations are already effective regarding the opening of legal procedures in support of the implementation of sanctions imposed by foreign jurisdictions. For instance, the obligations of European legal service providers in cases involving an extraterritorial legislation listed in the annex to the Blocking Statute Regulation are unclear. Such clarification should be included in the Commission's 'frequently asked questions' explanatory guidance and any existing obligation should be clearly communicated to the relevant legal service providers. Any obligation must in no way affect EU companies' rights to receive legal advice regarding their case.

- With regards to the possibility under Article 5 to receive authorisation for non-compliance under certain criteria, BusinessEurope would like to point out that such authorisations to specific sectors are not isolated but also have a significant impact on other sectors as they are relying on their services. Careful consideration between authorisations under Article 5 and protection/recovery of damages under Article 6 is key to ensure appropriate legal balance to protect the interests of the various affected sectors under EU legislation.
- Procedures for the request of authorisations for non-compliance should be simplified. The administrative burden for the argumentation of necessity of non-compliance as well as the required provision of documents should be kept to a minimum.
- It would be helpful to gather and share general information on how member states enforce prohibitions and how incompliance is sanctioned while respecting confidentiality and commercial concerns.
- It would be helpful that the Commission clarifies the status of European affiliates of US companies and service providers to establish if they are subject to the Blocking Statute Regulation like companies established directly within the EU (including the possible need to trigger Article 5 of the regulation to remain compliant with foreign legislations on a case-by-case basis if necessary).

- Article 6 (recovery of damages):
  - The recovery of damages under the Blocking Statute Regulation is limited as in many cases, the plaintiffs are individuals who hold limited or no assets that could be seized under a judicial proceeding in the EU, or companies face unclarities regarding the judicial proceeding that is a requirement for such claims. Hence, the protection of and support to companies is still largely ineffective under Article 6. In order to explore the possibility to recover losses the Commission should further clarify the procedures necessary to claim compensation in the Q&As, precising possible alternatives that would allow companies to get compensated in the event the other party does not hold assets in the EU.

Step up measures to defend European sovereignty in the area of sanctions

- To ensure a coherent approach and implementation and adequate enforcement of sanction policy across EU member states, setting up an intergovernmental platform of EU member states, coordinated by the European Commission with a very clearly targeted and limited scope, should be considered.
- This structure should:
  - constitute a European interlocutor for third countries in order to obtain clarifications in terms of compliance with sanctions.

  - act as a relay for European companies and provide support, both of technical and political nature. This is particularly important given the (deliberate) uncertainty around the operation of sanctions and the resulting tendency of financial services providers and companies in general to be extremely cautious to prevent any potential liability if left in doubt, including proceeding to a considerable reduction of their exposure to affected markets. This, together with the political imbalance between foreign judicial systems and individual affected companies, exacerbates the effect of third-party sanctions beyond their legal basis.
  - coordinate and support member states with a view to ensuring a coherent and unified approach to handling third-country sanctions (incl. the Blocking Statute Regulation) and implementing EU sanctions.
  - the exact setup of this body under coordination of the European Commission with close ties to member states should be explored and tested with member states.
- The toolbox to deter claims against EU companies based on specific third-country sanctions falling under the Blocking Statute Regulation should be enforced and allow for countermeasures to compensate unilateral decisions after a clear procedure. While keeping in mind restrictions due to different levels of competence, coordinated measures like visa restriction or asset freezes should be tested with member states.
- This intergovernmental platform should monitor cases in which third-country entities benefit directly or indirectly from absence of level playing field on other markets created by their domestic extraterritorial sanctions affecting European companies.

Reinforce the international role of the euro in international payments

- As the Commission communication noted, the most important factor driving the external use of the euro is the confidence of market participants in the euro itself. To continue to build confidence and generally strengthen the resilience of Europe's economy in the post-COVID-19 recovery, it is essential that the EU continues to deepen the EMU, particularly through completion of the Banking Union and the Capital Market Union and putting in place a stabilisation function to address asymmetric economic shocks in member states. The EU should also ensure the free flow of capital and encourage an efficient innovative payment system to support cross-border trade and the development of the (digital) Single Market. This will help to translate the economic power of the Single Market also into economic resilience and leverage.
- Identify market barriers and incentivise the greater external use of the euro, for instance by
  - Examining the scope to incentivise the use of the euro for financial institutions responding to market logic;

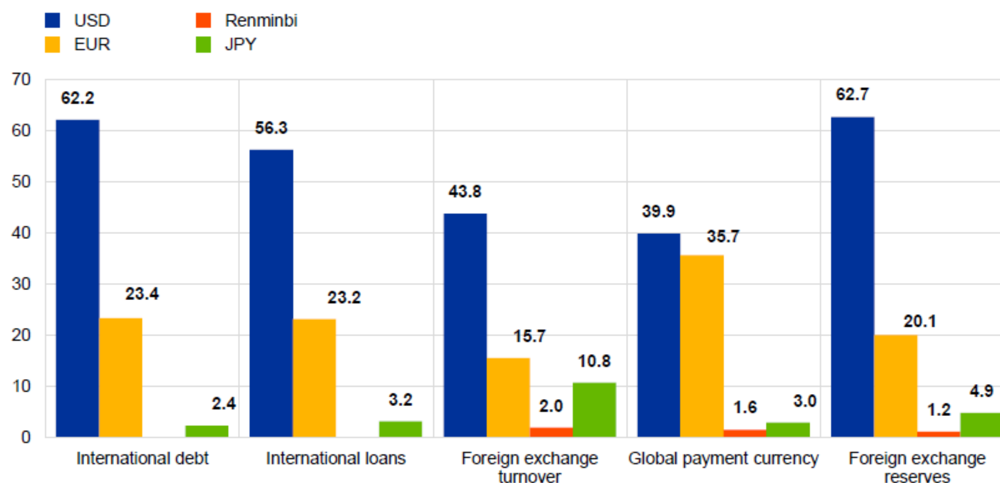
- Exploring options on how to decrease the costs of using the euro compared to the US dollar in certain transactions;
- Exploring general options on how to cover exchange rate risks, e.g. by the possibility of non-selective public guarantees;
- Working on euro benchmarking and referencing on some markets like oil (esp. downstream), gas, hydrogen, raw materials, metal or food commodities;
- Involving central banks;
- Rethinking the role of digital currencies and take the lead on digital payment system (to not have shady cryptocurrency subsystems and dark commerce).

BACKGROUND

Annex I: A stronger international role of the euro

The biggest challenge in the area of extraterritoriality of sanctions is the dominant role of the US dollar in the international financial system and its importance as the world's main reserve currency. Transactions across the world are conducted in dollars and, despite not being otherwise connected to the USA, they often run through US banks or clearing organisations which exposes such transactions to US sanctions law. A further complication is the impact on the SWIFT, the global financial transaction communication network which was established under Belgian law. For instance, the USA have put pressure on SWIFT to disconnect Iranian banks from its systems, basically cutting them off from the global system and making it technically extremely difficult for them to engage in financial transactions even with those financial institutions that would be willing to do so.

This has led to a reflection in the European Union on how to further the euro's global role to also better reflect the euro area's economic and financial weight.[1] The euro is the second most widely used currency accounting for 36% of global payments (the US dollar for 40%) in 2017. However, the share of the euro as international reserve currency is at 20% while the US dollar's share is 63%.



Graph from ECB interim report "The international role of the euro" (2018)

[1] The Commission has carried out a consultation on strengthening the role of the euro in the following five targeted sectors: foreign exchange markets; energy; non-energy, non-agricultural raw materials, metals and minerals; agricultural and food commodities; aircraft manufacturing, rail and maritime sector.

While there might be financial arguments speaking in favour of a wider global use of the euro (e.g. removal of exchange risks esp. for SMEs, lower interest rates asked by investors, more reliable access to finance, etc.), the most striking argument still seems to be the autonomy argument in the global financial system. However, the dollar still has significant advantages as a currency for international transactions and it will require meaningful political action and time to increase the attractiveness of the euro as an alternative for economic operators. Experts agree that the deepening of the Economic and Monetary Union as well as the completion of the Banking and Capital Market Unions are essential to strengthen the role of the euro globally.

A more political question would be whether the EU takes a decision to pursue an active agenda to increase the share of euro-denominated transactions in certain sectors in which the traditional role of the US dollar is still prevalent. The reasons for this differ between sectors. For instance, the oil industry is mainly trading in US dollars because the benchmarking is done in US dollars. In other sectors, esp. those with transactions of large sums, companies in the supply chain want to avoid running an exchange rate risk. In other sectors, business has an interest in maintaining flexibility regarding the choice of transaction currency for stronger bargaining positions.

Annex II: Iran and Cuba

In the case of Iran, upon its withdrawal from the Joint Comprehensive Plan of Action (JCPOA) the USA not only introduced new sanctions but also reintroduced “secondary sanctions” that had previously been lifted under the agreement. These are targeting the operations of non-US actors in the United States in the event they engage in transactions with the sanctioned country in listed areas. The extraterritorial reach of US sanctions law is particularly noticeable for EU companies and financial institutions because US law prohibits them from doing business that they are allowed to do under EU law. Despite measures taken by the EU to shield companies with the Blocking Statute Regulation, this led to a situation where companies operating both in Iran and the USA were practically deterred from continuing their legitimate business and upholding their contractual obligations in Iran to ensure their US market operations would not be hit by sanctions.

In the case of Cuba, the Helms-Burton Act allows for claims to be launched against EU companies doing business in and with Cuba on the basis of their trafficking in property confiscated by the Cuban government on or after 1 January 1959. European companies have invested in many sectors, including manufacturing, infrastructure and services making them vulnerable to claims. Furthermore, the US embargo against Cuba also means that US companies cannot do business involving services or products originating in Cuba. In case of very stringent application of the regime by the US Administration, European companies face problems with US service providers like banks, credit card systems, web hosting services, etc.

Annex III: Measures already taken

<u>The Blocking Statute Regulation</u>

Currently the EU's only direct tool at hand is the Regulation (EC) 2271/96 ("Blocking Statute Regulation") that is aimed at blocking the application of third-country secondary sanctions to EU actors, e.g. businesses and financial institutions (also EU subsidiaries and affiliates of US companies and US citizens resident in the EU). It **prohibits** EU actors under the risk of fines to

- Comply with any requirement or prohibition under listed US sanctions against Cuba, Libya and Iran ("the blocked sanctions");
- Recognise or enforce any judgement or decision of a judicial or administrative authority outside the EU giving effect to "blocked sanctions".

The Blocking Statute Regulation also foresees that EU actors that experience damage from the application of the "blocked sanctions" could recover a compensation from the entity causing the damage (e.g. a bank that refuses a transaction due to US sanctions). However, procedures remain unclear and the potentially most important claim item, which are penalties from US authorities for the breach of sanctions, cannot be claimed back due to state immunity. The regulation also includes, under specific criteria and on decision by the European Commission, the possibility of an authorisation for EU actors to comply with the US sanctions if not doing so would seriously damage EU operators' interests, or those of the EU.

Reacting to the US withdrawal from the JCPOA the Commission adopted the Implementing Regulation (EU) 2018/1101 which extended the scope of the Blocking Statute Regulation to add the new US sanctions and established criteria for authorising EU actors to comply with US sanctions and established procedures for the submission of authorisation requests.

In practice, the Blocking Statute Regulation has been very rarely used in its long history and the tool is considered largely ineffective due to a number of reasons. Most importantly, the damage being caused by a potential sanction on the US market or a cut-off from the US financial system is too high of a risk to take for a company, which is why despite the risk of fines under the regulation they choose to comply with US secondary sanctions. Furthermore, in the absence of a credible and workable indemnification mechanism, EU companies are caught between a rock and a hard place. Finally, additional guidance is needed for companies regarding the procedures for claims and authorisations under the regulation as well as for member states regarding the implementation of the regulation. Particularly, the role and leeway of member states in processing notifications and supporting companies should be clarified and harmonised. Given the possible diplomatic pressure resulting from third countries directly onto governments, it might be consequent to tighten member states' obligations to offer all necessary support to affected European companies.

Instrument in Support of Trade Exchanges (INSTEX)

In the case of Iran, upon its JCPOA withdrawal the USA not only introduced new sanctions but also reintroduced “secondary sanctions” that had previously been lifted under the agreement. These are targeting the operations of non-US actors in the United States in the event they engage in transactions with the sanctioned country in listed areas. The extraterritorial reach of US sanctions law is particularly noticeable for EU companies and financial institutions because US law prohibits them from doing business that they are allowed to do under EU law. Despite measures taken by the EU to shield companies with the Blocking Statute Regulation, this led to a situation where companies operating both in Iran and the USA were practically deterred from continuing their legitimate business and upholding their contractual obligations in Iran to ensure their US market operations would not be hit by sanctions.

Another action that was taken was to set up a special purpose vehicle (“Instrument in Support of Trade Exchanges”) that allows the accounting of economic exchanges with countries covered by American sanctions without using the dollar as transaction currency and without using access to the American financial system or SWIFT. The private entity was established in Paris in January 2019 by the UK, Germany and France and more countries have joined since. Its scope is currently limited to “legitimate trade” not under US sanctions (e.g. pharmaceuticals, medical devices, agri-food products). However, it has so far facilitated a limited number of transactions, related to humanitarian purposes in the context of the COVID-19 outbreak. In any case, the potential strengthening of US sanctions against Iran might include above-mentioned “legitimate trade” and hence make it difficult for INSTEX to act.