

INTERNATIONAL TRADE TRADE SANCTIONS - AN UPDATE DECEMBER 2011

Introduction

Our previous sanctions updates are available on the Ince & Co website at www.incelaw.com and should be read in conjunction with this latest update.

There have recently been a number of developments in international sanctions. Unrest has continued in the Middle East following the 'Arab Spring' and, in the last few months, we have seen the fall of the Qadhafi regime in Libya, the worsening of the humanitarian situation in Syria and the publication of the International Atomic Energy Agency's ("IAEA") report on Iran's nuclear programme. All of these developments have led to changes in the sanctions and restrictions that had previously been imposed by foreign governments.

The global scope and far-reaching effects of sanctions impact on all those involved in international trade and shipping regardless of their role. As such, anyone involved in these industries must ensure that they assess the impact of sanctions on their proposed transactions. This is even more important if they are based within or have links to the European Union and/or United States. Aside from the legal implications of contravening sanctions, the reputational damage that can result from negative media coverage can adversely impact businesses and could lead to investigation by the authorities.

This article is intended to provide an overview of the recent events relating to sanctions against Iran and Syria, but is not intended to be a substitute for thoroughly evaluating and assessing the impact of sanctions on you or your business.

Iran

On 18 November 2011, the IAEA published its report on Iran's nuclear programme which linked the uranium enrichment programme in the country to military development. This has led to growing international concern that, despite Iran's assertions that the programme is for peaceful purposes, there is an underlying military objective. The intended nature of this programme has led to the imposition of new sanctions by amongst others the EU, UK and US who have extended their existing sanctions regimes against Iran. The aim of these measures is to increase the pressure on the Iranian government to desist from any military development of nuclear materials and to return to the international negotiating table on this issue.

We comment on recent EU, UK and US developments.

European Union sanctions

On 1 December 2011, European Union foreign ministers met in Brussels to discuss, amongst other matters, the imposition of sanctions on Iran and Syria (which we comment on further below). Prior to the meeting, there were suggestions that the EU could ban imports of Iranian crude oil. Ultimately, however, this restriction must have been a step too far for a number of Member States and was not agreed upon, although there has been a suggestion that further sanctions will be introduced in the near future, targeting Iran's energy and oil industry.

Following those discussions, on 2 December, EU Regulation 1245/2011 entered into force. It has added 143 entities and 37 individuals to the list of those subject to a freeze of assets and economic resources in the EU. The restrictions that apply to these entities and individuals are set out in the main legislation dealing with Iranian sanctions, EU Regulation 961/2010. The entities and individuals which have been designated on this occasion include a large number said to be owned, controlled or acting on behalf of the Islamic Republic of Iran Shipping Lines ("IRISL"), whilst others are said to be controlled by or linked to the Islamic Revolutionary Guard Corps ("IRGC"). Funds and economic resources cannot be provided directly or indirectly to these 'sanctioned persons'.

It should be noted that EU sanctions apply to EU nationals wherever located in the world and it is, therefore, important that if you are an EU national, even where you are working for a foreign company outside of the EU, you comply with the sanctions.

It is vital that those involved in shipping and trade conduct due diligence on any counterparties to ensure that they have neither been designated as sanctioned persons nor are they owned or controlled by a sanctioned person. While entities based in Iran may be considered higher risk, it is worth noting that the locations of sanctioned persons in the latest EU legislation includes companies and individuals based in China, Dubai, Germany, Hong Kong, Malta, the Marshall Islands, Turkey and Singapore. The international scope of these designations means that, even where a transaction appears to have no link to sanctions, the underlying ownership or control of the counterparty could be in the hands of a sanctioned party and could give rise to a breach of sanctions if the transaction proceeds.

UK sanctions against Iran

As of 21 November 2011, the UK Government introduced legislation under the Counter-Terrorism Act 2008 with immediate effect. This legislation prohibits persons in the UK financial sector from entering into, or continuing to participate in, any transaction or business relationship with banks incorporated in Iran and the Central Bank of Iran (“the Direction”). It is important to note that the definition of “financial institutions” is wide enough to cover authorised insurance companies which would include entities such as P&I insurers.

The Direction extends to the subsidiaries and branches of banks incorporated in Iran wherever they are located in the world. The legislation was introduced because of the authorities' belief “that the activity in Iran that facilitates the development or production of nuclear weapons poses a significant risk to the national interests of the UK” and that “Iranian financial institutions actively provide many of the financial services which underpin the procurement of goods and material from abroad for Iran's nuclear and ballistic missile programmes”. The restrictions are intended to ensure that the UK financial sector does not unwittingly facilitate the financing of Iranian nuclear proliferation, given the serious risk that Iran's activities pose to the UK's national interests.

Applications for licences to exempt specific transactions/relationships from the restrictions can be made to the Treasury. Six general licences are also available in respect of:

- > transactions for or related to humanitarian activities or purposes;
- > transactions for or related to personal remittances;
- > transactions related to the provision of insurance which is permitted under Article 26(2) and (3) of EU Regulation 961/2010;
- > the holding of asset-frozen Iranian banks' accounts;
- > the holding of accounts in the names of Iranian banks; and
- > the completion of payments to/from Iranian banks which were in progress at the time of the Order coming into force.

Guidance published by HM Treasury notes that this Direction requires “relevant” persons i.e. financial institutions, to cease transactions and relationships with designated persons and goes on to say that exporters are unlikely to be relevant persons because “the Direction is not intended to serve as a trade ban with Iranian companies, even though the UK Government does not encourage such trade”. The Guidance does, however, acknowledge that the Direction will make it harder to trade with Iran as UK banks would be prohibited from handling payments to or from banks in Iran unless the Treasury has licensed the transaction.

In Iran, the events that followed this legislation have led to a worsening in UK and Iranian relations as the Iranian Parliament voted to downgrade relations with the UK and protesters subsequently ‘stormed’ the UK embassy in Tehran, a move believed by the UK authorities to have had a degree of Iranian governmental acceptance. The latest move has seen the UK close its embassy in Iran and expel all Iranian diplomats from the UK. The breakdown in relations and the introduction of further sanctions are likely to make it increasingly difficult to conduct trade linked with Iran.

US sanctions against Iran*

The US has also strengthened its sanctions against Iran in a number of ways, most notably for the international business community through Executive Order 13590 which, like CISADA before it, has extraterritorial effect.

Executive Order 13590 authorises the US Secretary of State to impose financial sanctions in the US on any party (including successors and affiliates) who:

- a. *knowingly, on or after the effective date of this order, sells, leases, or provides to Iran goods, services, technology, or support that has a fair market value of \$1,000,000 or more or that, during a 12 month period, has an aggregate fair market value of \$5,000,000 or more, and that could directly and significantly contribute to the maintenance or enhancement of Iran's ability to develop petroleum resources located in Iran;*
- b. *knowingly, on or after the effective date of this order, sells, leases, or provides to Iran goods, services, technology, or support that has a fair market value of \$250,000 or more or that, during a 12 month period, has an aggregate fair market value of \$1,000,000 or more, and that could directly and significantly contribute to the maintenance or expansion of Iran's domestic production of petrochemical products; [our emphasis]*

The Order is very widely drafted and it is difficult to say with certainty how the US will interpret what will constitute a “direct and significant contribution”. From the definitions that are included in the Order it is, however, clear that “to develop petroleum resources” includes exploring for, extracting, refining, or transporting by pipeline petroleum resources.

Perhaps of most concern to those involved in the Iranian petrochemical industry is the dramatic reduction in the financial thresholds which apply. The threshold for sanctionable investment in the development of Iran's ability to develop its petroleum resources has been cut from \$20 million to \$5 million, while the threshold at which sanctions will apply to a person who knowingly sells, leases or provides goods or services to Iran which will significantly contribute to the maintenance or expansion of Iran's production of petroleum products is based on a fair market value of \$250,000 or, during a 12 month period, an aggregate of \$1 million. How these thresholds will be calculated, however, remains uncertain.

Looking at this legislation, it could be argued that providing ships to transport Iran's petrochemical products, or the insurance of such transportation, constitutes a significant contribution to the maintenance or enhancement of Iran's ability to develop its petroleum resources. The position, however, is not clear. In light of this, the International Group of P&I Clubs has reportedly sought guidance from the US authorities on a number of issues arising from the Order, including whether the transportation by sea of petroleum resources into or out of Iran and the insurance of vessels performing such trades will now attract sanctions, as well as guidance on how the financial thresholds should be calculated.

In light of the uncertainties surrounding this legislation, we strongly recommend that those with specific concerns seek US legal advice.

Syria

As the pressure on Syria increases with the imposition of sanctions by the Arab League and continued pressure from other countries, it is becoming increasingly difficult to conduct trade with Syria.

European Union Sanctions

Council Regulation (EU) No 950/2011 of 23 September 2011 amends the main legislation against Syria and adds to the lists of Syrian persons/entities subject to the EU's asset freeze.

As of 23 September 2011, prohibitions have been introduced on the granting of any financial loan or credit to, the acquisition or extension of a participation in, or the creation of any joint venture with any Syrian person, entity or body involved in the exploration, production or refining of crude oil. It is also prohibited to participate, knowingly and intentionally, in activities the object or effect of which is to circumvent the prohibitions referred to above. It should be noted that these prohibitions do not apply to obligations or extensions arising from contracts or agreements concluded before 23 September 2011.

In addition, Regulation 950/2011 added two persons and six entities (including Cham Holdings, the largest holding company in Syria) to the asset freeze. On 13 October 2011, by Regulation (EU) No 1011/2011, the Commercial Bank of Syria was added to the list of entities subject to the asset freeze.

More recently, on 2 December 2011, EU Regulation 1244/2011 further expanded the list of persons, entities and individuals subject to the asset freeze. The two most notable additions are the Syria Trading Oil Company (Sytrol) and General Petroleum Company (GPC). The designation of these two entities is likely to impact on those dealing with oil and petroleum products in Syria. Under the EU sanctions against Syria (and as with other sanctions legislation), it is prohibited to make funds and economic resources available, either directly or indirectly, to an entity that has been designated as a sanctioned person.

Also on 2 December 2011, the Council of the European Union introduced Decision 2011/782/CFSP, which enacts further measures against Syria, including a prohibition on the provision of (re)insurance to the Syrian government in the EU, restrictions on the export of key equipment for the oil and gas industry in Syria and a prohibition on investing or assisting with the construction of Syrian power plants.

What can you do to protect yourselves?

In brief, there are certain things which you and your business can do to protect yourselves against breaches of sanctions, including but not limited to:

- > carrying out due diligence on the transaction and evaluating the counterparties involved;
- > the inclusion of adequate protection in contracts to cover sanctions and, in particular, a mechanism for contractual termination should the sanctions change;
- > the implementation of internal compliance procedures and policies to ensure that transactions comply with sanctions; and
- > training those within the business to understand the risks posed by sanctions.

Summary

For now, there seems to be little prospect of an end to the sanctions legislation. If anything, the next few weeks are likely to see further developments and increasingly stringent restrictions on trade with Iran and Syria. Against this background, it is vitally important that all transactions are considered carefully with the sanctions legislation in mind. Contracts that are entered into now may well give rise to obligations which are to be performed later down the line. There is, therefore, a risk that the sanctions legislation may have changed by the time the obligation arises, in the worst case making it illegal to proceed or at the very least making it difficult for you to comply with the contract (if, for example, licences or authorisations are required). It is, therefore, advisable to consider these risks when entering into any contracts for the future performance of work and to try to allocate the risks accordingly.

It is also imperative to undertake thorough due diligence on any transactions with a particular focus on the counterparties and, where there is concern regarding a particular issue, to seek legal advice or guidance from the relevant authorities.

The above summarises some recent sanctions developments but is not intended to act as an alternative to obtaining legal advice. If sanctions issues arise in your business, we recommend that you get in touch with your usual contact at Ince & Co LLP or speak directly to Michelle Linderman.

*Note: we are not qualified to advise on US law. However, we can provide recommendations if you require assistance from US lawyers.



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