

INTERNATIONAL TRADE TRADE SANCTIONS AGAINST IRAN AN UPDATE - JANUARY 2011

Introduction

In September 2010, we published a detailed overview of international trade sanctions against Iran. That overview can be accessed via our website. This article is intended to summarise the principal developments in this area since that overview, primarily with regard to the enactment by the European Union of new measures aimed at preventing the acquisition of Nuclear weapons by Iran. The latest sanctions are contained in "Council Regulation (EU) No. 961/2010 of 25 October 2010 (the 'Regulation') on restrictive measures against Iran and repealing Regulation (EC) No. 423/2007".

Background to the Regulation

On 31 August 2010, the EU published a draft of the proposed implementing Regulation to supplement the EU Council Decision of 26 July 2010 which we discussed in our last overview. As then worded, the draft provisions of the Regulation caused some concern in the shipping, trade and insurance sectors. After a consultation period involving submissions by various interested groups in those affected industries, the final version of the Regulation was passed. Below is our review of some aspects of the Regulation, with a particular emphasis on how it may affect those in the shipping, insurance and energy industry.

European Union Regulation No. 961/2010

The Regulation entered into force on 27 October 2010, the date of its publication in the Official Journal of the European Union. The Regulation states that it is binding in its entirety and directly applicable in all Member States – no further domestic legislation is required to bring it into force.

Who is subject to the Regulation?

Article 39 sets out the application of the Regulation to those with an EU nexus as follows:

"This Regulation shall apply:

- a. *within the territory of the Union, including its airspace;*
- b. *on board any aircraft or any vessel under the jurisdiction of a Member State;*
- c. *to any person inside or outside the territory of the Union who is a national of a Member State;*

- d. *to any legal person, entity or body which is incorporated or constituted under the law of a Member State;*
- e. *to any legal person, entity or body in respect of any business done in whole or in part within the Union."*

Given the broad application of the Regulation, it is important that all Companies that are registered within the EU, employ EU nationals or those companies that transact business within the EU consider the scope of the latest restrictions. As such, international trade transactions which on their face appear to have no link to the EU, because for example they are between two companies based outside of the EU such as Singapore and Dubai, may be subject to the EU jurisdiction, through the employment of EU nationals involved in taking various decisions in the transaction process.

What are the aims of the Regulation?

The sanctions imposed by the Regulation are far wider in scope than those set out by the UN in the Council decision of 26 July 2010. The Regulation seeks to restrict investment in Iran and to restrict trade with Iran with a particular focus on the Iranian oil and gas industry. In addition, the Regulation sets out restrictions relating to the provision of insurance/reinsurance to Iranian entities; restricts transfers of funds from/to Iranian entities; restricts the provision of financial services and, imposes restrictions on transport. We comment on some of the key provisions below.

Shipping

Export and Import Restrictions

In the various Annexes to the Regulation, a number of items are listed which are subject to export and import restrictions.

These are mainly military and dual use items as well as items that might be used for "internal repression". Care should therefore be taken if a transaction involves one of these listed items as the sale, supply, transfer or export, directly or indirectly, to any Iranian person of such items for use in Iran is prohibited. Further, participating, knowingly and intentionally, in activities the object or effect of which is to circumvent this prohibition is prohibited. A shipment of 'seals' may appear to be a legitimate cargo but dependent on the exact specifications of the 'seals' these could be prohibited listed items intended to assist the Nuclear industry in Iran.

It is worth bearing in mind that even when items which are not included in the Annexes are supplied to Iran they may be converted and used in the military industry in Iran. Although the supplier and shipper may have no specific knowledge or suspicion that this could happen at the time that the transaction takes place and efforts may have been made to ensure that the relevant sanctions are being complied with, the possibility of negative media and commercial coverage is another factor to consider. There have already been examples where the media have shown pictures of a truck (displaying a company name/logo) adapted to carry ballistic missiles in Iran even though the vehicle was originally sent to Iran as a commercial truck. This may have a damaging impact on the commercial reputation of a company.

Parties involved in the shipment of goods that fall within the Annexes must take great care to ensure that they carry out adequate checks to identify the precise nature of the cargo and where it is intended for as well as the parties involved to avoid breaching the Regulation. In relation to some goods authorisations can be obtained from the competent authority of the relevant Member State.

Oil and Gas shipments

It has been widely reported that US legislation has targeted the refined petroleum industry in Iran and in particular has placed restrictions on the importation into Iran of refined petroleum. The EU, although targeting the Oil and Gas industry with a number of specific restrictions relating to the supply of materials to that sector has noted in the preamble to the Regulation that the restrictive measures should not prevent the import or export of oil or gas to and from Iran including payment for those goods. This demonstrates a difference between the EU and US approach in relation to the supply to Iran of Oil and gas. However, given the scope of international business with the US and payments in the US Dollar, it is important that companies still assess the impact of the US sanctions if they are considering supplying oil or gas to Iran.

Freezing of Funds and Economic Resources

Under Article 16, all funds and economic resources belonging to or held by designated individuals listed at Annex VII and VIII are frozen. In addition to this, no funds or economic resources

are to be made available directly or indirectly for the benefit of those bodies or persons listed in Annex VII and VIII. This restriction is important for those involved in providing cargo to Iran especially where a third party such as an Iranian bank which has been designated in the Regulation may be listed as the consignee.

The definition of "economic resources" in the Regulation is wide so that material items which can be used to obtain funds, goods or services are classified as an economic resource. Given the wide definition of the Regulation it is important that those in the shipping industry consider all contracts and Bills of Lading to ensure that no listed person is the consignee of a cargo. A number of Iranian Banks are listed in Annexes VII and VIII of the Regulation and Iranian entities may list these as consignees under Letter of Credit arrangements. Although the cargo itself might be permitted, it is possible a document with a listed entity as the consignee could be enough to fall foul of this provision.

Restrictions on Transport

Article 27 requires that all goods being transported between the EU and Iran (significantly, not just goods that might be covered by the prohibited categories) have the requisite pre-arrival/pre-departure information so that this can be submitted to the relevant customs authorities in the Member State. Where this information provides reasonable grounds to believe the vessel in question is carrying prohibited goods, the cargo may be inspected and, if necessary, seized or disposed of (Article 28). Article 28(1) further states that EU nationals are prohibited from providing bunkering or ship supply services to vessels owned or controlled, directly or indirectly, by an Iranian person, entity or body where they have information, including information from the customs authorities, which provides reasonable grounds to believe the vessels are carrying prohibited goods.

The implementation of the EU Advance Cargo Declaration Regime on 1 January 2011 for the shipping industry provides for the submission of Cargo information to a Customs office in relation to the import or export of goods from the EU. This article does not consider the detailed provisions of this Regime but it is important that aside from the restrictions on Iran, ship operators are complying with this Customs Regime. Many shippers will already be familiar with a similar customs regime in the US. Under the Regime, the ship operator is the person liable

to declare the cargo information in advance to the Customs office. As a result, the Owner and Charterers should ensure that it is clearly stated in the Charterparty or other contractual document who is going to submit the information to the relevant authorities and any allocation of liability as a result of incorrect submission of documentation. This Regime should enable the EU Customs authorities to gather the required information necessary to ensure that goods to or from Iran can be appropriately assessed and supports the provisions of the Regulation pertaining to transport.

Insurance

Article 26 of the Regulation prohibits the provision of insurance or re-insurance to Iranian companies, to a company owned or controlled by an Iranian company, to subsidiaries of Iranian companies outside Iran and to natural persons acting on behalf of such companies or entities. However, the ban does not apply to the insurance or reinsurance of vessel owners or charterers that do not appear on the EU "blacklist" (Article 26(3)). Article 26(3) also allows insurance/re-insurance to be provided to vessels which are only docking, loading, unloading or transiting "temporarily" in Iranian waters.

While many involved in the insurance industry have ceased any involvement with Iranian entities especially in the renewals of insurance policies, dangers can still arise in relation to the provision of insurance to bodies acting on behalf of an Iranian entity. It is possible that a company could be set-up in a third country which is owned entirely or by a majority Iranian entity. The risk is that the provision of insurance/re-insurance to this company could breach Article 26 of the Regulation.

The exact application of this restriction to the variety of roles active in the insurance industry is unclear. For example, there is no clear guidance on how these insurance provisions affect the role of brokers who are not actually insuring the underlying risks but placing the risk in the market. While there is little guidance from the authorities and given the wide scope of the legislation, it would be advisable to remain vigilant when looking at any insurance or reinsurance policies which are linked to Iran.

Restrictions on Transfers of Funds and on Financial Services

It is not the purpose of this update to give a detailed review of the various provisions in relation to financial transactions and investment. In broad terms, however, the new Regulation implements the financial restrictions set out in the Council

Decision of 26 July 2010, which we summarised in our previous overview. It also clarifies the obligations of financial institutions in relation to record-keeping and reporting requirements regarding Iranian-related banks, as well as the opening of accounts, the establishment of correspondent or joint venture banking relationships with Iranian-related banks and the opening of new offices, branches or subsidiaries in Iran.

Restrictions are placed on the transfer of funds to and from an Iranian person, entity or body where that payment is over EUR 40,000. (Transfers below that sum must, however, still be notified to the competent authorities of the relevant Member State). To prevent circumvention, the Regulation applies to those transactions which appear to be linked and so therefore parties are unable to reduce the size of the payments under the threshold amount in order to try to avoid the sanctions. Where any payment is being received or paid to an Iranian entity the restrictions should be complied with. This could include the payment of a claim under an Insurance policy, payment of money under a Charterparty and also payments from Iranian businesses for cargo.

Further practical difficulties may be encountered when the payment is processed by a financial institution. The major financial institutions have sophisticated software to detect where payments are being made to Iran or companies associated with Iran. Although the payment may be legal under the various sanctions, delays could still be encountered while the financial institution carries out its own compliance checks. Financial institutions may even refuse the payment if they believe there is a risk that it breaches their own compliance procedures.

Energy

This update is not intended to provide a detailed analysis of the new EU Regulation in relation to the energy industry. However, the Regulation confirms restrictions on trade in key equipment and technology for, and restrictions on investment in the Iranian oil and gas industry (Articles 8 and 9). Whilst these restrictions do not apply to trade contracts concluded before the Council Decision of 26 July 2010 came into force, or to investments in Iran made before 26 July 2010, those engaging in relevant transactions or providing assistance to them will still have to notify the relevant authorities of what they are doing at least 20 working days in advance.

Is there any defence to an allegation of breach of the Regulation?

Article 32 of the Regulation provides a defence to liability where the person or body *'did not know, and had no reasonable cause to suspect, that their actions would infringe these prohibitions.'* It remains to be seen what this will mean in practice and there is, as yet, no guidance. As such, we recommend that careful checks are carried out and procedures put in place by those who are transacting business with an Iranian connection. Equally, given that some parties may seek to avoid the sanctions by disguising the true end user or destination for goods, if you have suspicions extra checks should be carried out and records kept of those checks. Organised record keeping of checks that have been made on transactions and entities will be important should any authorities later investigate a transaction that has taken place in the past.

Diversions Countries

A number of countries have become known as 'diversion risks' whereby Iranian companies are using third party companies in a number of countries to purchase goods before sending them onto Iran. With the third party acting as a front for an Iranian business the transaction may appear to have no connection to Iran and so therefore sanctions issues may not be considered. It is important however that where there is a suspicion that Iran may be involved all the entities in the transaction are considered and checks carried out where possible. For instance, a warning sign could be that a small company in Country X is ordering a large amount of restricted items under the Regulation when it would appear to have no use for this quantity of goods. It could be purchasing the items on behalf of an Iranian sanctioned individual. If the goods are supplied and the third party was known as a suspicious Iranian front company, it may be deemed that it should have been known that the sanctions would be breached.

There have already been reports of bill of lading scams and other methods being used to evade the trade sanctions. For example, it was recently mentioned in the maritime press that there have been a number of documented instances where cargoes are being loaded in Iran but shipped to a second country in the Middle East Gulf region. The original bill of lading is then altered to indicate that the cargo was loaded in that second country. It was also been reported that Iranian products, such as petrochemicals, were being shipped from Iran under

doctored bills of lading which stated that the products emanated from another source of origin, such as India.

UK legislation update

On 11 December 2010, the UK implemented 'The Iran (European Union Financial Sanctions) Regulations 2010'. This Statutory Instrument includes provisions preventing the circumvention of restrictions and most importantly imposes penalties for any breach. These can include a fine or in certain cases imprisonment. Given that the penalties are now imposed in domestic legislation, it is even more important that applicable sanctions are complied with.

The Financial Restrictions (Iran) Order 2009, which we summarised in our last briefing, has now expired after having been in force for one year. However, the new EU Regulation applies in the UK as of 27 October 2010. HM Treasury has now issued a Financial Sanctions/Counter Illicit Finance Notice, available from the Treasury's website, providing a detailed commentary on and guidance to complying with the EU Regulation. HM Treasury is the competent authority in the UK for issuing licences, giving notifications and making requests for authorisation relating to the transfer of funds subject to reporting requirements. Any existing licences issued by HM Treasury under the previous legislation will now be deemed to have been issued under the new Regulation and remain valid. New licences will be issued pursuant to the requirements under the new Regulation.

As well as the UK Treasury a number of other government bodies are responsible for the application and enforcement of the Regulation and UK sanctions policies. Both the Department for Business, Innovation and Skills and Her Majesty's Revenue and Customs deal with the enforcement of sanctions and in particular the provision of certain materials to Iran. Should a licence be required for transactions involving Iran, this must be obtained from the relevant Government department.

Export Controls

It is important that companies are aware of the relevant export controls applicable in the jurisdictions relevant to their transactions. Although the various international sanctions legislation may be complied with, this does not automatically mean that the relevant export legislation has also been satisfied. Licences may be needed from the relevant government departments and in some cases the penalties for a

breach of export legislation are similar to a breach of sanctions and include large fines and possibly imprisonment. Export controls are specific to each jurisdiction and even where there is no physical export from the country, the arrangement of transfers between third party countries may still be subject to Export legislation, especially where one of the third party countries is sanctioned by that jurisdiction. It is advisable that export controls are considered in tandem with sanctions legislation by those involved in international trade matters.

Specially Designated Nationals

The US Treasury Department's Office of Foreign Assets Control (OFAC) still maintains a list of Specially Designated Nationals (SDNs) with whom dealings are prohibited. The EU and UK also maintains a similar list of SDNs. All the lists are maintained by the relevant State authority and reflect the latest additions to sanctioned persons. Where a transaction with Iran is taking place we would advise that these lists are checked both prior to the transaction and indeed at regular times during the course of a transaction. In addition to the US, EU and UK lists other jurisdictions may maintain similar lists of individuals and entities who trade is restricted with.

US enforcement

On 28 September 2010, the US Treasury's Office of Foreign Assets ("OFAC") published a final rule amending the Iranian Transactions Regulations to remove two general licences authorising the importation into the US of, and dealings in, certain foodstuffs and carpets of Iranian origin and related services. As of that date, imports into the US of Iranian-origin foodstuffs and carpets is prohibited without a specific license which is unlikely to be granted absent special circumstances.

This final rule also implements certain import and export prohibitions contained in the Comprehensive Iran Sanctions, Accountability and Divestment Act 2010 ("CISADA") Relating to importation of goods or services of Iranian origin directly or indirectly into the US and on US origin goods, services or technology from the US or a US person in Iran.

The US has targeted those companies that are used by Iran as front companies. A particular target of the sanctions has been IRISL. As recently as 13 January 2011 a number of shipping companies in Hong Kong were sanctioned as being linked to IRISL. Although there have not been any recent actions against

major international companies it is unlikely that this enforcement will take place immediately and it will take the authorities a period of time to gather evidence by which to sanction various companies.

Sanctions Clauses

With the increase in international sanctions many parties are now incorporating sanctions clauses into their contracts. These clauses are designed to protect against a breach of sanctions and allocate any subsequent liability. Where a Contract incorporates a sanctions clause it is advisable that should there be any subsequent contracts, for example in a chain of charterparties, there is equivalent protection from sanctions at each stage to ensure that if a breach occurs, a party in the chain of contracts will not suffer another party's breach of sanctions as a result of a failure to ensure back to back provisions (or at least wider protection) throughout the chain.

In relation to shipping, BIMCO has introduced a sanctions clause for Time Charters. Although a number of clauses have been produced in this area, we would advise that any sanctions clause should be adapted to cover the specific risks that you or your business is trying to protect. Not all contracts will be the same and given the wide scope of international sanctions, there may be specific concerns with certain sanctions legislation. Care should be taken when incorporating or accepting any sanctions clauses in contracts.

Contact Us

This briefing is intended to provide a general overview of the sanctions and the types of issues that have already arisen and may arise as a result. Where specific advice is needed on any aspect of the sanctions and their potential effect in relation to any jurisdiction or trade sector, we recommend that you approach your usual contact at Ince & Co or those listed.



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