

# IRAN SANCTIONS UPDATE

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The effects of sanctions imposed against Iranian entities by the US, the UN, the EU and the UK are already extensive. They are set to become even more far reaching following a number of recent developments during June and July 2010.

On 9 June 2010, the UN Security Council passed Resolution No 1929 (2010), imposing further UN sanctions on Iranian entities. On 10 June 2010, the UK responded by including individuals and entities targeted by the UN Resolution within its own sanctions regime.

On 1 July 2010, President Obama signed the Iran Sanctions, Accountability & Investment Act of 2010, HR 2194 ("the US Act"). This retains and expands the sanctions already imposed by the US and is specifically intended to increase their extra-territorial effect and their impact on non-US persons. The US Act took immediate effect and the new sanctions will be imposed on activities taking place on or after 1 July 2010. Activities already underway at that date may also be caught.

An EU sanctions regime against Iranian entities has also now come into force on 26 July 2010, although further implementing measures are likely to be required to give this regime its full effect.

There are therefore several layers of sanctions against Iranian entities. The exact extent of those sanctions will vary from country to country. In any particular transaction (for example, a shipment of goods by sea) a number of systems of law will be relevant – the law applicable to each of the contracts, the law of the places of shipment and discharge, the law of the flag of the vessel, and the law of the place of incorporation of the various entities involved. This will affect shipowners, shippers, receivers, charterers, traders, insurers and financiers. An even higher degree of caution will therefore be required in any dealings relating to Iran in order to avoid any breach of the various sanctions regimes now in force. The full impact of the new sanctions has yet to be fully worked out, but the key questions in relation to any trade connected with Iran will be:

- Who are your counterparties and are they persons who are the direct subject of sanctions?
- Are any of the parties in the contractual chain in that position?
- Are you satisfied that the cargo does not fall within any of the sanctions legislation?
- Can you make/receive payment from your counterparties?
- Can you obtain insurance?

## EU Sanctions

The EU has now on 26 July 2010 published Council Regulation no. 668/2010 (the “Regulation”). This, together with the Decision referred to below, had been the subject of much advance publicity, and the prohibitions contained in the Regulation and Decision have been described as “unprecedented”.

The form of the Regulation is to amend Annex V of an earlier regulation (423/2007 of 19 April 2007). That imposed an asset freeze on the individual and entities identified in it. The Regulation now adds a number of names to those identified in the previous regulation, including several groups of banks, aerospace companies, energy companies and a number of entities allegedly associated with the Islamic Republic of Iran Shipping Lines (“IRISL”).

Prior to publication of these sanctions, there had been references in the Press to the possibility of the EU taking steps to ban Iranian vessels from European waters. However, the Regulation explicitly

records that the obligation to freeze economic resources of designated entities of the IRISL does not require the impounding or detention of vessels owned by such entities or the cargoes carried by them in so far as such cargoes belong to third parties, nor does it require the detention of the crew contracted by them.

IRISL has however been included as one of the entities identified under Annex V, “(including all branches) and subsidiaries”.

In addition to the Regulation, the Council of the European Union has also published a Decision on 26 July 2010 (the “Decision”) which contains a number of wide ranging measures (described by the Council itself as “comprehensive and robust”) in the areas of trade, financial services, energy, transport and asset freezing. The Decision formally binds only member states, and requires further implementing measures by the member states or the EU. The European Commission is likely to adopt an implementing regulation in early September. Implementing measures by member states may be adopted sooner, but, as a matter of caution, many EU nationals are already seeking to comply with the terms of the Decision. In the case of the United Kingdom, the relevant implementing measure is currently the Iran (European Community Financial Sanctions) Regulations 2007, S.I. No. 1374 of 2007. This makes “dealing with” the funds or economic resources of designated persons without a licence from HM Treasury a criminal offence.

Our understanding of the current position is that the UK Government intends to provide guidance for

exporters on the Decision by the middle of August 2010. The European Commission is aiming to circulate a first draft of its implementing Regulation in early September, which will then be the subject of negotiation between EU member states. It is possible that the UK may not implement any national measures in respect of the Decision before the European Commission Regulation is finalised (although the position is likely to be different in respect of other member states).

## Export and import restrictions

The decision contains a prohibition on the direct or indirect supply, sale or transfer of a number of specific items to, or for the use in, or benefit of, Iran, by nationals of member states, or through the territories of member states, or using their flag vessels or aircrafts. The prohibited items include any items which could contribute to enrichment-related, reprocessing or heavy water related activities, or to the development of nuclear weapon delivery systems, weapons and ammunition, and dual-use goods.

## Energy

There is a further prohibition on the sale, supply or transfer of key equipment and technology for the key sectors of the oil and natural gas industry in Iran, or to Iranian or Iranian-owned enterprises engaged in those sectors outside of Iran, by nationals of member states, or from the territories of member states, or using vessels or aircraft under the jurisdiction of member states.

## Restrictions on financing

Amongst other matters, there is a restriction on the granting of any financial loan or credit to enterprises in Iran that are engaged in the key sectors of the Iranian oil and gas industry, or to Iranian or Iranian-owned enterprises engaged in those sectors outside of Iran. There is a similar prohibition on the creation of joint ventures.

The decision also directs member states to exercise restraint in entering into new short term commitments for public and private provided financial support for trade with Iran, including the granting of export credits, guarantees or insurance. There is also a prohibition on the opening of new branches, subsidiaries or representative offices of Iranian banks in the territories of member states.

## Insurance

There is a prohibition on the provision of insurance and reinsurance to the Government of Iran, or to entities incorporated in Iran or subject to Iran's jurisdiction, or to any individuals or entities acting on their behalf or at their direction, or to entities owned or controlled by them.

## Transport

There is an obligation on member states to inspect all cargo to and from Iran in their territories if they have information which provides reasonable grounds to believe that the cargo contains items the supply, sale, transfer or export of which is prohibited under the decision.

The provision by nationals of member

states, or from territories under the jurisdiction of member states, of bunkering or ship supply services, or other servicing of vessels, to Iranian owned or contracted vessels (including chartered vessels) is prohibited if they have information that provides reasonable grounds to believe that the vessels carry prohibited items.

## Freezing of funds and economic resources

All funds and economic resources belonging to certain specified persons are frozen. The prohibition also extends to persons and entities not specifically identified, but who are engaged in, directly associated with or provide support for Iran's nuclear activities or the development of nuclear weapon delivery systems.

No funds or economic resources shall be made available, directly or indirectly, to or for the benefit of any such persons and entities.

## The United Kingdom legislation

The position under UK legislation is, in relative terms, fairly straightforward. Under the Iran (Financial Sanctions) Order 2007, which implements UN Regulation 1737 (2006) of 23 December 2006, two primary offences are created. Firstly, there is a prohibition on any person from dealing with funds or economic resources owned, held, or controlled by a "designated person", unless he does so under the authority of a licence from the Treasury.

Secondly, a person must not make funds or economic resources available, directly or indirectly, to

or for the benefit of a "designated person" unless he does so under the authority of a licence from the Treasury.

Breach of these provisions is a criminal offence, with substantial penalties.

"Funds" is very widely drafted to include financial assets and benefits of every kind.

To "deal with" funds is again widely drafted to mean to use, alter, move, allow access to or transfer funds.

A "designated person" is a person designated in accordance with the UN Security Council Resolution 1737 (2006) adopted on 23 December 2006, and also any person identified in a direction given by the Treasury.

Now, on 26 July 2010, a decision of the EU Council and the EU Regulation, seek to impose further sanctions over a wide range of activities.

The list of designated persons is extensive, and is published on the HM Treasury website.

Further parties were added by the UN Security Council Resolution 1929 (2010), and have become designated persons by virtue of a Treasury Direction of 10 June 2010. This now includes subsidiaries of IRISL, namely Irano Hind Shipping Company, IRISL Benelux N.V. and South Shipping Line Iran.

Further additions can be anticipated from time to time.

There are separate domestic financial restrictions on Bank Mellat and IRISL,

and any branch of either of them, under the Financial Restrictions (Iran) Order 2009.

## US Sanctions

The US Treasury Department's Office of Foreign Assets Control ("OFAC") administers the Iranian Transactions Regulations ("ITR"), a comprehensive set of sanctions against Iranian entities. OFAC asserts jurisdiction over US persons and over transactions and services that come within its jurisdiction.

### Prohibitions on US persons

The ITR contains a general prohibition on US persons from engaging in any transaction with the Government of Iran or persons in Iran. This includes imports from and exports to Iran, whether directly or indirectly. These restrictions are therefore significantly wider than the UN and EU sanctions, which are directed at specific products and specified parties.

A US subsidiary of a non-US entity will be caught by this prohibition.

### Prohibitions on non-US entities, including restrictions on the payment process

The ITR also extends to non-US persons in certain circumstances. Non-US persons are prohibited from causing a US person to export goods, services or technology to Iran. A non-US person could therefore fall within the jurisdiction of OFAC if they were to engage in a transaction or service which involves a person who is within the jurisdiction of OFAC. A recent example of this was reported in December 2009, where Lloyds TSB agreed to a settlement with OFAC of

US\$217m, in circumstances where it was alleged that Lloyds had routed a number of electronic funds transfers through banks located in the US in apparent violation of the OFAC regulations relating to Iran and other countries. It should be noted that the activities of Lloyds took place entirely outside of the US, but resulted in the breach of OFAC regulations by a US person, in that payment instructions were transmitted by Lloyds to banks in the US. These banks were then themselves in breach of the OFAC regulations by processing those requests.

The effect of this is that almost any US\$ payment to an Iranian entity would cause a US financial institution to be in breach of the OFAC sanctions. In order to avoid this risk, a widespread practice has developed of payments to Iranian entities being made in Euros.

In addition, the US Act which came into effect on 1 July 2010 seeks to curtail imports of petroleum into Iran through sanctions on companies providing refined petroleum to Iran, or transporting, insuring or financing refined petroleum deliveries. The sanctions will affect persons who sell or provide to Iran refined petroleum products with a fair market value of US\$1m or more or, over a 12 month period, an aggregate fair market value

of US\$5m or more. The sanctions also extend to anyone who sells or provides to Iran goods or services which facilitate the maintenance or expansion of Iran's domestic production of refined petroleum products.

As well as imposing sanctions and penalties on foreign financial institutions that contravene the sanctions regime, the US Act prohibits US financial institutions from entering into transactions with foreign financial institutions which also undertake transactions with designated Iranian banks or other parties. The US institutions will be required to establish policies, perform audit activities and provide certification to show that the foreign financial institutions with which they do business do not contravene the US Act.

### Letters of credit

A number of banks have sought to include terms in documentary credits to provide that, for example, the presentation of documents which are not in compliance with any sanctions legislation will not be accepted. Alternatively, banks may state that they undertake no obligation to make any payment under a letter of credit if there is involvement by any person listed in any relevant sanctions list.

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**“If charterers do not issue alternative voyage orders, then owners will have the right to discharge the cargo at a convenient port or place and claim the costs from charterers.”**



A guidance paper issued by the ICC Banking Commission at the end of March 2010 commented on the growing practice of many banks to include these so called sanctions clauses in their transactions. It expressed concern as to how this practice will affect the reimbursement provisions of the UCP 600 and noted that nominated banks face particular difficulties since they may not be aware of the sanction policies that issuing banks will apply in each case. This may cast doubt on their prospects of reimbursement when they pay a conforming presentation.

Some banks have also circulated notices to their customers urging them to exercise due diligence to ensure that the transaction in question (including associated transport arrangements) does not contravene any relevant sanctions legislation, and advising that the bank will not handle a document or payment which relates to a sanctioned vessel, goods or counterparties.

## Charterparties

In July 2010, following liaison with the international group of P&I Clubs, BIMCO produced a charterparty clause dealing with the effects of sanctions. The BIMCO sanctions clause is designed so that, if a voyage is already under way when sanctions come into effect, the owners can require charterers to issue alternative voyage orders and to indemnify the owners against any claims arising from that change. If charterers do not issue alternative voyage orders, then owners will have the right to discharge the cargo at a convenient port or place and claim the costs from charterers.

BIMCO have expressed concern that any contravention of sanctions could result in not only shipowners, but also crew members, managers, insurers and reinsurers being affected. The clause is intended to provide owners with a means to assess and act on a voyage order issued by a time charterer which might expose the vessel to a risk of sanctions. Owners must exercise their “reasonable judgement” when assessing the risk.

A number of other issues are likely to arise from sanctions legislation, including the extra territorial effect of legislation; the position of a charterer in the middle of a charterparty chain who discovers that orders have been given which would involve the vessel being engaged in activities which contravene one or more sets of legislation; and the position of a buyer or seller of goods who discovers that a buyer or seller elsewhere in a chain is a party whose activities may be in contravention of sanctions legislation.

Increased due diligence will be one partial answer to some of these issues, but there is no doubt that extended contractual undertakings, warranties and indemnity provisions are likely to result.

We will keep you updated on the continuing impact of the sanctions legislation, as well as any further additions to the sanctions regime.

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