

# Trade Sanctions against Iran – an overview

September 2010



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## Introduction

The ongoing international initiative to adopt new and tighten existing trade sanctions against Iran is presenting companies and financial institutions engaged in or facilitating business with Iran with significant challenges. The expressed purpose of the various national and international authorities imposing new sanctions is to curb any attempts by Iran to develop a nuclear weapons programme and to prevent its involvement in financing terrorism. The sanctions are therefore primarily focused on restricting dealings in the energy sector, particularly in the oil, gas and nuclear industries, while also restricting investment and financing of certain enterprises in Iran. Iran is currently unable to meet its domestic fuel consumption due to a lack of sufficient refining facilities and has to import refined petroleum products. The new restrictions are intended to deprive Iran of such imports and stifle the improvement of related facilities in Iran. Nonetheless, the impact of the sanctions will also resonate in the international trade, shipping and financial sectors.

## Categories of sanctions

There are four categories of sanctions: United Nations restrictions; European Union restrictions; United States restrictions and national restrictions. In respect of the latter, a number of countries have introduced or are in the process of introducing national legislation to implement international sanctions into domestic law and/or to introduce domestic sanctions packages of their own. By way of example, there has been recent press coverage of steps being taken by jurisdictions such as Australia, Canada, Switzerland, Japan and South Korea, to fall into line with the proactive approach being taken on an international level to pressure Iran into complying with its international nuclear obligations.

## Knock-on effect

Companies which are based in countries not directly subject to EU/US sanctions are having to take a view on whether their economic interests are best served by

maintaining a trading relationship with Iran or foregoing that connection in order to protect their share of the market elsewhere. For example, there have been recent reports that a Japanese carmaker has suspended exports to Iran in order to preserve its primary position in the US car market. South Korea has apparently caved in to pressure from the US to close down Bank Mellat's Seoul branch, albeit this closure is said to be temporary.

In addition, countries such as the UAE are seeking to achieve a balance between their international commitments pursuant to the relevant UN resolutions and their legitimate business transactions with Iran. Nonetheless, reports indicate that imports from and through the UAE are already being affected, with ships carrying petroleum to Iran facing greater scrutiny and closer tracking at UAE ports which have previously been used by Iran to transport fuel cargoes. Insurers operating within the UAE are also reportedly not underwriting new risks of Iranian interests which fall within the UN/US sanctions.

## Summary of sanctions

### United Nations Sanctions

On 9 June 2010, the UN adopted the fourth in a series of Security Council Resolutions (UNSCR 1929 of 2010) intended to put a stop to Iran's nuclear activities. In addition to imposing an effective arms embargo on Iran, the Resolution introduced further sanctions and added a number of target entities to which these and existing sanctions should apply.

The measures previously adopted by the UN against Iran are still in force, including the restrictions on the sale and supply of goods and technology for use in nuclear activities and the financial sanctions on target entities. The new measures, activated whenever there are reasonable grounds to believe that activities are contributing to Iran's nuclear initiative, include:

- prohibition on the provision of financial services, including insurance cover to Iranian entities;
- prohibition on providing bunkers or other services to Iranian owned or chartered vessels;
- inspection of ships, aircraft and cargo heading to or from Iran and of ships on the high seas if prohibited cargo is suspected to be aboard (only with the consent of the flag State and therefore without prejudice to the established UN law of the sea);
- prohibition on business with the Islamic Revolutionary Guard Corps or designated Islamic Republic of Iran Shipping Lines (IRISL) related entities; and
- prohibition on opening any branch or subsidiary of an Iranian bank in a UN Member State (including a reciprocal prohibition on UN Member State banks opening up in Iran).

### European Union trade restrictions

#### *2007 Measures*

In 2007, the EU implemented a Regulation and a Council Decision enacting existing UN sanctions in EU Member States. In broad terms, EU Regulation 423/2007 introduced a prohibition on (i) the direct and indirect sale, supply, transfer or export of certain goods (including dual use items) and technology, which could be used in nuclear activities by any Iranian entity or in Iran; and (ii) the provision of any related direct or

indirect technical assistance, brokering services, manufacturing investment, financing or financial assistance. The Regulation also provided a "blacklist" of persons, entities and bodies whose assets should be frozen by EU Member States.

#### *2010 Measures – Regulation and EU Council Decision*

##### Regulation 668/2010

With effect from 27 July 2010, EU Regulation 668/2010 added to the list of Iranian target entities whose funds and economic resources are frozen pursuant to EU Regulation 423/2007. The list of targets now includes all branches and subsidiaries of IRISL, Iran Insurance Company, all branches and subsidiaries of Bank Mellat, subsidiaries of Bank Melli, all branches and subsidiaries of Bank Sederat Iran, Iran Aircraft Industries, Iran Aircraft Manufacturing Company, and Iran Aviation Industries Organisation.

The Regulation provides a very broad definition of the freezing of funds and this will extend to the provision of credit. The terms "economic resources" and "funds" are also wide in scope. The former includes assets of every kind, including ships, aircraft and commodities. The latter includes, *inter alia*, securities and debt instruments, credit, rights of set off, letters of credit and bills of lading.

In addition to the freezing of assets, no funds or economic resources may be made available, directly or indirectly, to the target entities. Attempts to circumvent any of the measures taken against the target entities, with knowledge and intent, is also prohibited.

##### EU Council Decision

Unlike the Regulation, which takes immediate and direct effect in EU Member States without any national implementing legislation, the EU Council Decision of 26 July 2010 has to be implemented into national legislation before it becomes binding on individuals and companies within the EU. Until then, it is only binding on the governments of the Member States. It is anticipated that EU Member States (including the UK) will take the relevant measures to implement the Council Decision into national law and will do so promptly. Furthermore, the Council Decision is to be supplemented by a further EU Regulation to clarify certain matters, including detail on implementation, compliance and enforcement

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measures. A draft of the proposed implementing Regulation has been published and it is expected that it will enter into force September 2010. In broad terms, the Council Decision provides as follows:

**Oil & Gas industry:** a prohibition on the sale, supply or transfer of key equipment and technology for the refining, liquefied natural gas, exploration and production industries. This is supplemented with wide provisions relating to technical and financial assistance similar to the existing provisions in relation to nuclear activities. There are also restrictions on investment, financing and commercial activity with the oil and gas industry in Iran. The ban applies to contracts and investments post-dating adoption of the Council Decision on 27 July 2010.

**Transport:** additional import/export information will be required for all goods passing between Member States and Iran. Member States will have to inspect all cargo to and from Iran (seaports and airports) provided that they have information that provides reasonable grounds to believe that the cargo being carried contains prohibited items. There is also an obligation on Member States to co-operate with requests for inspection on the high seas. Prohibited items will be seized and disposed of by Member States at the cost of those involved with the attempted contravention.

**Bunkering and supply:** nationals of Member States must not provide bunkering, supply or other servicing to Iranian owned or contracted vessels (including chartered vessels) if they have information which provides reasonable grounds to believe that the vessels carry prohibited items.

**Insurance:** a complete prohibition on the provision of insurance/re-insurance to the Government of Iran or any entities incorporated in Iran or anyone acting on behalf of, owned or controlled by such entities.

**Financial sector:** no further commitments of credit to the government of Iran, including through their participation in international financial institutions, as well as restrictions on new short term commitments of financial support for trade with Iran. Member States will have to implement enhanced monitoring activities over banks with connections to Iran and any transfer of funds to or from Iran shall be subject to new notification and authorisation requirements depending on the amount and subject matter involved. It will also be prohibited to participate in the direct or indirect sale or purchase of bonds

issued or guaranteed by Iran. Member States may not open new offices, subsidiaries or banking accounts in Iran and Iranian banks are prohibited from establishing new branches, subsidiaries, offices, joint ventures or ownership interests in EU Member States.

**Aviation:** access to airports in Member States shall be denied for cargo flights operated by Iranian carriers or originating from Iran. There are also restrictions placed on nationals of Member States relating to the engineering and maintenance services to Iranian cargo aircraft if they have information that provides reasonable grounds to believe that the cargo aircraft carry prohibited items.

Worth noting, however, is that the draft proposed EU Regulation provides a defence in respect of certain prohibited transactions and activities under the legislation where those concerned *“did not know, and had no reasonable cause to suspect, that their actions would infringe these prohibitions”* (Article 31).

#### **Domestic trade restrictions – the UK**

The EU 2007 measures are reflected in the UK Treasury’s Iran (European Community Financial Sanctions) Regulations 2007. These Regulations provide for criminal penalties in case of contravention. Recent reports indicate that a major bank is presently under investigation by the FSA over payments that have allegedly contravened this and other related UK Treasury legislation.

In October 2009, the UK Financial Restrictions (Iran) Order 2009 came into effect. This Order prohibits UK financial and credit institutions from dealing with Bank Mellat and with IRISL and their subsidiaries. This legislation applies to UK banks and insurers, although exempting licences can be applied for and obtained from the Treasury in certain circumstances.

The UK Government is expected to enact legislation to implement the latest EU Council Decision into national law in or around September 2010. As already stated, Regulation 668/2010 is already directly effective in the UK.

#### **US trade sanctions**

The US sanctions are administered by the US Treasury Department’s Office of Foreign Assets Control (OFAC). Amongst other things, OFAC has a list of Specially Designated Nationals (SDNs) or blocked persons with whom dealings are

prohibited. The names of new SDNs are regularly added to this list. It is recommended that OFAC's website be consulted for detailed information and ongoing updates on US sanctions and any new SDNs.

## CISADA 2010

Since 1995, US ship owners and insurers have been prohibited from participating in trade with or involving Iran. In 1997, virtually all trade and investment activities with Iran by US persons, wherever located, was prohibited. On 1 July 2010, the Comprehensive Iran Sanctions, Accountability and Divestment Act 2010 (CISADA) was brought into force in the US. CISADA strengthens existing US sanctions against Iran in restricting Iran's access to *inter alia* gasoline and other petroleum products, petroleum-related investment, credit and financial services. CISADA also restricts activities for which an exempting licence would have previously been available. On 16 August 2010, OFAC published its new Iranian Financial Sanctions Regulations (IFSR) to implement certain provisions of CISADA.

Significantly, CISADA extends the extra-territorial reach of the existing sanctions in targeting non-US entities and individuals and imposing sanctions on, for example, non-US ship owners and insurers supporting prohibited trade with Iran. It also authorises sanctions not only against entities conducting Iran-related business but also on their parent companies. Corporate ownership structure will therefore become a significant consideration.

CISADA amended the Iran Sanctions Act of 1996 (ISA) which authorised the President to sanction non-US companies that invested significantly in the Iranian petroleum industry (although reportedly no sanctions were ever imposed under that legislation). It also extends the menu of sanctions under the Act of 1996 which may be imposed on behalf of the President and which now includes the refusal of loans over US\$10 million in any one year, the freezing of assets within the US and prohibitions on entering into foreign exchange transactions within the US in which the targeted person has an interest. Furthermore, contravention of the US rules will be made public, which could result in reputational damage.

CISADA now provides expressly for the imposition of sanctions if a US person or entity has *inter alia* knowingly:

- sold, leased or provided to Iran goods, services, technology, information, or provided support that could contribute to the maintenance or expansion of Iran's domestic production of refined petroleum products (subject to a threshold of up to US\$1 million in any 12 month period or US\$5 million in aggregate);
- sold or provided to Iran any refined petroleum products (with a market value of more than US\$1 million in any 12 month period or US\$5 million in aggregate); or
- provided related insurance, financing or broking services;
- provided ships or shipping services to deliver refined petroleum products to Iran;
- invested US\$20 million or more in directly and significantly contributing to the enhancement of Iran's ability to develop petroleum resources.

The definition of "knowingly" under CISADA will cover actual or constructive knowledge. This differs from ISA which extended only to actual knowledge. "Refined petroleum products" is defined as diesel, gasoline, jet fuel and aviation gasoline.

Furthermore, non-US banks may be identified by the US Treasury as participating in Proscribed Banking Activities with prohibited entities. In those circumstances, the designated bank may be precluded from certain activities such as maintaining or accessing US correspondent bank accounts. However, where the non-US bank has complied with locally applicable rules (for example, where EU banks comply with the EU sanctions), it is predicted that the US will be unlikely to penalise them under US legislation in a bid to avoid soured diplomatic relations with countries that are co-operating with the US in their efforts to isolate Iran. This principle of comity is also anticipated to extend to EU companies who comply with EU sanctions even if, for example, they engage in activities that might contravene US sanctions. However, only time will tell as to whether this prediction that the US will seek to be politically sensitive in implementing the new US measures turns out to be true.

## How will these sanctions impact your business?

### Shipping contracts

The sanctions have implications for those involved in the chartering of ships and transfer of negotiable documents. In the first instance,

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reliable systems will have to be put in place to ascertain the identity of all parties to a transaction or chain of transactions, including the owners of ships, the charterers and the owners and consignees of cargo. Notwithstanding such systems being operational, there remains a risk that blacklisted entities/ships and prohibited cargo might slip through the net not least because blacklisted entities have and will no doubt continue to take steps to try to conceal the ownership or identity of vessels and/or to take whatever steps they can to enable them to continue trading.

This presents a clear risk to charterers, consignors and freight forwarders and underlines the need for comprehensive vessel-vetting procedures to be carried out in every case.

In terms of existing charter parties, namely those concluded prior to the relevant sanctions coming into force, there is a risk that a charterer will order the vessel to carry refined petroleum products for discharge in Iran or that the charterer might conduct a voyage that is in breach of the sanctions. Whether or not such an order can be refused will depend on the charter party provisions. Possible arguments which might arise are that the order is illegal as the vessel is only permitted to carry lawful merchandise in lawful trades. Alternatively, there might be an argument that the voyage has been frustrated due to supervening illegality. One potential way of trying to avoid such problems arising is for the parties to agree an addendum to the charter party.

In terms of future charter parties, the parties are advised to agree protective clauses. For example, Intertanko has published a sanctions clause which is perceived to be "owner-friendly". BIMCO, in conjunction with some of its members, has also published a sanctions clause for time charters. BIMCO reports that the objective of its sanctions clause is to provide owners with a means to assess and act on any voyage order issued by a time charterer which might expose the vessel to the risk of sanctions. The test is one of "reasonable judgment" by the owners in determining whether the risk of imposition of sanctions is tangible.

A major shipowner and its US subsidiaries have recently been fined by the US authorities for infringement of past sanctions relating to Sudan and Iran by providing unlicensed shipping services for cargo shipments to those two

countries. This suggests that future sanctions infringements of shipping companies will be treated in an equally stringent fashion by the US authorities.

## **Insurance**

P&I Clubs are at risk if cover is inadvertently placed over a prohibited cargo or ship engaged in prohibited activities, and if Members (or their brokers) engage in prohibited activity or contract with a target entity. This potential exposure has led to the insertion of sanctions compliance clauses into policies, for example that cover under the policy will be suspended if the assured is in breach of sanctions and the assured must then indemnify the insurer in respect of loss sustained as a result of such breach. Some Clubs have also changed their rules or are in the process of doing so, with a view to preventing the Clubs being found to be in breach. Such changes include loss of cover or termination of membership as soon as the Club is exposed to the risk of contravention, for example if a Member's vessel, whether entered with the Club or not, is employed in a carriage, trade or voyage which will expose the Club to the risk of being or becoming subject to any sanction.

A number of the P&I Clubs have been issuing circulars to their Members to keep them updated on developments relating to the various sanctions and advising them how to proceed and what the potential effects might be. It is recommended that any owner or time charterer entered with one of the P&I Clubs keeps a close eye on guidelines and briefings issued by its Club.

More generally, Lloyd's of London, the world's largest insurance market, has confirmed it will back the US sanctions. Cover for shipments to Iran has consequently been significantly curtailed. Furthermore, the Lloyd's Market Association (LMA) has now produced a sanctions clause for its members which, although designed for the marine insurance market, may also be used in non-marine policies.

## **Finance**

Given that many contracts provide for transactions to be undertaken in US Dollars, there will be an ongoing risk that international trade and financial dealings will contravene US sanctions and incur significant penalties. US lawyers would have to be consulted for specific

advice in the event that there is any concern in this regard. However, in broad terms, any US dollar transactions passing through the US banking system may be at risk of being frozen if they can be traced to Specially Designated Nationals under the US legislation.

A number of banks have already paid the price of past non-compliance with US sanctions. One has recently settled a claim for over US\$200 million in respect of breaches that took place in relation to non-US banks outside the US but where funds passed through the US and were related to prohibited transactions. Other banks have also recently been ordered to pay substantial fines in respect of US sanctions violations relating to various countries including Iran, said violations going back a number of years.

Some financial organisations are taking pre-emptive steps to protect themselves, with one bank known to have produced a sanctions clause for ship finance transactions. Kuwait's central bank is also reportedly rejecting bids from Iranian banks to open branches in Kuwait after they failed to meet the required criteria. Swiss banks are reported to have frozen the accounts of 40 Iranian companies so far. Other banks who have not yet implemented relevant procedures are likely to do so as part of their due diligence procedures.

## Who is benefitting from the sanctions?

Iran is a major supplier of crude oil to China, the world's second largest consumer of oil after the US. In the first half of 2010, Iran was China's biggest supplier of crude oil, with shipments of nine million tonnes. Whilst China has backed the latest UN sanctions, it is reportedly resisting US pressure to cut back on its existing oil and trade projects with

Tehran. China's vice premier was recently quoted as saying that China was Iran's main economic partner. Given that reportedly a number of leading traders and oil companies have stopped selling refined products and frozen gasoline sales, a great opportunity has been created for Chinese oil traders.

Russian oil traders are also expected to benefit. The Russian press has reported that Russian companies are discussing significant deliveries to Iran later this year. One Russian oil company is reported to have resumed gasoline sales to Iran in partnership with a Chinese state-run firm, notwithstanding that it has significant exposure in the US. The company has indicated that these were one-off shipments that took place within the framework of previously concluded contracts. Nonetheless, Russia's energy minister has stated that Russian companies would supply fuel to Iran if the terms were attractive and there were significant commercial interests involved.

## 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 partner Michelle Linderman ([michelle.linderman@incelaw.com](mailto:michelle.linderman@incelaw.com)), who has been involved in advising on a number of matters involving the sanctions and has given a number of presentations on this subject.

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