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Sanctions

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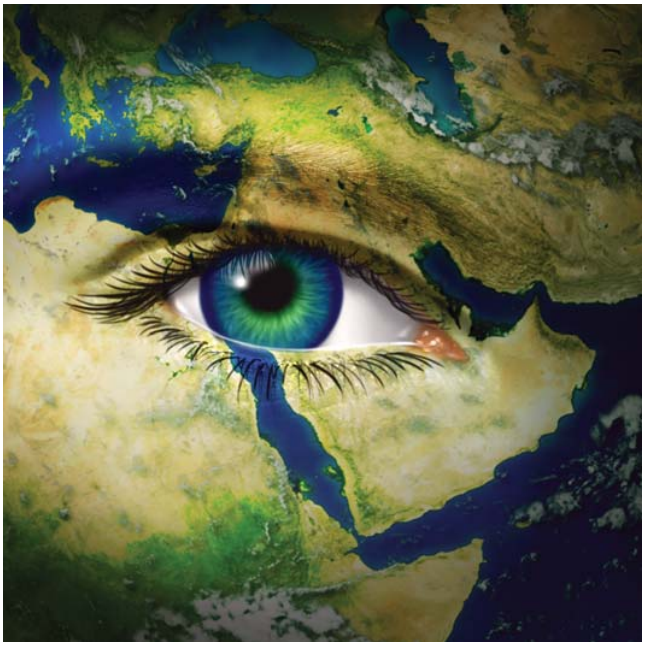
Targeting the shipping industry

Bruce Paulsen and **Benay Josselson**, of Seward & Kissel, look at the latest US sanctions against Iran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On 24 May 2011, the US government unleashed a wide array of sanctions on both foreign and US companies in the shipping sector, after largely foregoing enforcement of the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (CISADA) from its inception.

The pace since then has been fast and furious. Iran is a big market for the shipping industry – the temptation to ignore the growing body of sanctions regulations law and remain in that market is significant. Nevertheless, as the number and scope of applicable sanctions – and risk – has continued to increase.

CISADA is based on the theory that by crippling Iran's petroleum business, its ability to develop nuclear weapons will be hampered. Subject to certain monetary thresholds, CISADA prohibits any person, wherever located, from making certain investments, selling, leasing, or providing to Iran, goods, services, technology, information, or support which could facilitate the maintenance or expansion of Iran's domestic production of refined petroleum products, its ability to develop petroleum resources, or its ability to import refined petroleum products.

The imposition of sanctions is based on the activity at issue (whether with respect to "refined petroleum products" or "petroleum resources") and the monetary threshold involved. As to both refined petroleum products and petroleum resources, restrictions apply to any individual transaction with a fair market value of at least US$1m or a total of transactions of $5m or more during one year.

Under CISADA, in the event that a person is found to be subject to sanctions, three of nine potential sanctions must be imposed. The most onerous potential sanction is being barred from transactions conducted in US dollars.

On 24 May 2011, the US government, which had previously barely enforced CISADA, sanctioned seven companies, emphasising the fact that banks, brokers, shipping and insurance companies all run the risk of being sanctioned when they participate in activities relating to shipping refined petroleum products to Iran.

Explaining that the provision of goods and services, including financing and insurance, to entities that ship refined petroleum products to Iran under CISADA was sanctional conduct, the state department provided illustrative examples of other potentially sanctionable activities under CISADA, including:

- Use of a ship, controlled by ownership or charter agreement, to provide shipping services to supply Iran with gasoline, diesel, jet fuel, or aviation gasoline;
- Charter of a ship to another company that is using the ship to supply Iran with gasoline, diesel, jet fuel, or aviation gasoline, even if the ship owner does not have full control of the ship under the charter;
- Facilitation (eg brokering) of the provision of the ship, either by sale or charter, to a company for the transportation of refined petroleum products to Iran;
- Provision of insurance (including cargo insurance, P&I insurance, hull insurance, and contract frustration insurance) to a company for the transportation of refined petroleum products to Iran, if the insurance premiums are above threshold amounts;
- Facilitation (eg by brokering) of the provision of insurance for the transportation of refined petroleum products to Iran;

> **"The temptation to ignore the growing body of sanctions regulations law and remain in that market is significant"**

- Use of a ship, controlled by ownership or charter agreement, to provide shipping services for the purpose of supplying goods to be used to maintain or expand Iran's refineries,
- Facilitation (eg by brokering) of the provision of cargo or insurance to a company for the purpose of supplying goods, or to facilitate the transportation of goods, to maintain or expand Iran's refineries;
- Provision of insurance to a company for the transportation of goods to maintain or expand Iran's refineries.

The end of 2011 brought a new focus to this growing sanctions regime: the petrochemical industry. In a co-ordinated effort to increase international pressure on Iran, the US, the UK and Canada took action in November 2011 to confront the threat posed by Iran's refusal to comply with its international obligations, to increase its international isolation, and to address concerns about the development of its nuclear program.

On 19 November 2011, President Obama signed an Executive Order which, for the first time, specifically targeted Iran's petrochemical industry, a significant source of Iran's export revenues, which the US says has developed into a cover for the importation of sanctioned products.

It authorises sanctions for any person who "knowingly… 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."

The language of this new order does not sanction any person who participates in the exportation of petrochemical products. However, as indicated by the State Department when the order issued, the US has embarked on a worldwide diplomatic campaign to encourage governments and companies that purchase petrochemicals from Iran to switch to other sources of supply to further reduce Iran's export earnings.

"US sanctions regulations with respect to Iran have serious consequences for both US and non-US businesses"

Tighter grip

A few days later, on 21 November, based on Iran's support of terrorism, including the alleged sponsorship of an assassination attempt on the Saudi ambassador to the US, the Department of the Treasury identified Iran as a jurisdiction of "Primary Money Laundering Concern" under section 311 of the PATRIOT Act. This marked the first time that Treasury had identified the entire Iranian financial sector—including Bank Markazi, the Central Bank of Iran, private banks, branches, and subsidiaries of Iranian banks operating outside of Iran, as posing illicit risks to the entire financial system. At the time, however, the US stopped short of directly sanctioning Iran's Central Bank.

A week later, on 28 November, the US Senate unanimously adopted an amendment (the "Kirk-Menendez Amendment") to a generic military appropriations act. The Kirk-Menendez Amendment targets anyone doing business with the Central Bank in an attempt to force foreign financial institutions to choose between buying oil from Iran or being blocked from the US banking system.

Sanctions relating to transactions involving the purchase of petroleum or petroleum products running through foreign financial institutions owned or controlled by a foreign government become effective 60 days after 31 December 2011. However, the sanctions relating to transactions with respect to governments purchasing Iranian oil and selling petroleum products will not take effect for six months. This phasing-in period provides foreign institutions with time to transition out of existing Iranian oil contracts running through the Central Bank and find new sources of oil.

When President Obama signed the bill into law, however, he issued a signing statement noting his objections to the Iran sanctions portion. Additionally, President Obama retains some flexibility in administering the sanctions and has authority to waive the imposition of sanctions if he determines a waiver to be in the best interest of the country's national security, so long as he provides Congress with a justification for the waiver.

There has been no sign that the US government intends to relent on the imposition of new sanctions in 2012. Picking up right where Congress left off in 2011, on 2 February 2012, the Senate Banking Committee unanimously approved the Iran Sanctions, Accountability and Human Rights Act.

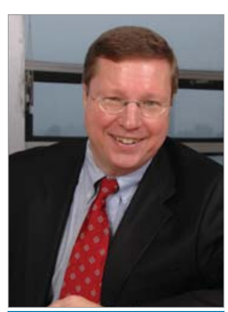
Closing loopholes

It is a bipartisan bill which, among other things, codifies the extension of sanctions to Iran's petrochemical sector, compels the Administration to investigate links between the Revolutionary Guard and Iran's oil industry; and makes US parent companies liable for business done by their foreign subsidiaries where it is prohibited for US persons. On 5 February, President Obama signed yet another Executive Order, closing certain loopholes with respect to dealings with the Central Bank by requiring US persons to freeze all Iranian assets or property (as opposed to requiring them to reject such transactions). And on 14 February, the Treasury issued guidance on the scope and application of the Kirk-Mendez Amendment.

It is apparent that US sanctions regulations with respect to Iran have serious consequences for both US and non-US businesses, particularly those within the shipping industry. As a result of this regime, as well as the sanctions regimes imposed by European countries, companies within the shipping sector are re-evaluating their relationships with Iran.

With sanctions becoming more onerous, insurance becoming more difficult to get, financing being more difficult to obtain and compliance becoming a serious undertaking, it has become less cost-effective, to say the least, and much riskier to transact business with Iran. During the first two weeks of February 2012 alone, Overseas Shipping Group, Frontline Ltd, AP Moller Maersk A/S and Teekay Tankers Ltd, in addition to smaller shipowners, announced they would no longer call in Iran. In other words, shipowners are reacting exactly how the US (and other countries) have hoped.

Ultimately, all companies must weigh the commercial benefits of any transaction or activity related, directly or indirectly, to Iran, against the potential ramifications, which can be significant. Given the pace with which the sanctions landscape is changing, consultation with qualified counsel before undertaking such a transaction is highly recommended. *MRI*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