1. Executive summary

1.1. This briefing is intended to give a broad overview of the impact of sanctions regimes on shipping finance. It is intended primarily for shipping financiers (lenders and lessors) but will also be of interest to shipping companies. This area is increasingly complicated, with a number of different sanctions regimes targeted at the same issues but applying different or overlapping sanctions. New regulations come out every few months or even more frequently and now often include provisions which are specifically directed at shipping and marine insurance, notably the Iran Threat Reduction and Syria Human Rights Act 2012 of the U.S., which came into effect from 1 July 2013, and Council Regulation (EU) No. 267/2012, as expanded. Shipping companies are now having to put compliance procedures in place. As described below (4.8, 4.10, 4.11, 6.5 and 6.6) litigation in England and elsewhere has been generated by the effect of sanctions on shipping and marine insurance, with particular reference to illegality and frustration of contracts. There are likely to be more cases. The impact of sanctions on different clients in general and on particular transactions which those clients have entered into, or may be contemplating entering into, requires specific advice. This briefing can be no more than a general alert.

1.2. By way of summary, this briefing addresses the following, in order:

- some background on the development of sanctions;
- the approach taken historically by shipping financiers to sanctions – a developing and fluid area in light of recent and continuing developments;
- some issues relating to the impact of sanctions regimes on the shipping industry and its lenders;
- issues created by different sanctions regimes being applicable to financiers and their shipping customers;
- specific issues relating to Iran; and
- some conclusions and issues to address further.
2. Background on the development of sanctions

2.1 The United States has a long history of imposing sanctions through Presidential Orders, Department of Treasury regulations, statutes and, through the U.S. Department of Treasury, Office of Foreign Asset Control (OFAC), a continually changing list of “specially designated nationals”. Currently, the U.S. has sanctions in effect against the following countries: Belarus, Burma (Myanmar), Cuba, Democratic Republic of the Congo, Iran, Iraq, Ivory Coast, Lebanon, Liberia, Libya, North Korea, Somalia, Sudan, Syria, Yemen and Zimbabwe. The sanctions vary in scope from a complete prohibition on all transactions by U.S. persons as well as a prohibition on certain transactions by non-U.S. persons with certain sanctioned countries, to sanctions targeted at certain individuals in certain sanctioned countries on the “Special Designated National” (SDN) list maintained by OFAC.

2.2 U.S. sanctions apply to different countries in different ways. Generally, they apply to “U.S. persons” or “persons subject to the jurisdiction of the U.S.”. However, increasingly the U.S. sanctions regime relating to Iran is expanding to include non-U.S. persons, using the threat of denial of access to the U.S. financial system as a means to encourage compliance with the sanctions (Certain earlier U.S. sanctions having extra-territorial effect are the subject of EU “counter-measures” and Germany has a general “counter-measures” law; see 2.8).

2.3 EU sanctions and trade embargoes expanded significantly in the 1990s and in the first decade of this century. There are currently over 30 countries named in EU sanctions or trade embargoes of one kind or another. Significant publications on the background to, and implementation of EU sanctions are: “Basic Principles on the Use of Restrictive Measures (Sanctions)”, Council of the European Union Document 10198/04; and “Guidelines – Restrictive Measures”, Council of the European Union Document 11205/12, as updated.

2.4 An ever increasing international sanctions regime directed at Iran has developed since UN Security Council Resolution 1737 (2006) and now UN Security Council Resolution 1929 (2010). The current U.S. sanctions against Iran began in 1987, and have been amended a number of times to date. The U.S. sanctions have expanded from, in their initial form, relatively narrow, targeted sanctions applicable only to U.S. persons to, currently, a broad prohibition on transactions with Iran by U.S. persons or by foreign entities controlled by U.S. persons, and a prohibition on certain transactions by non-U.S. persons with Iran, the violation of which could result in the closing of access to the U.S. financial system to such non-U.S. persons. In 2007 the EU implemented sanctions in respect of Iran. These initial sanctions were superseded and expanded upon by Council Regulation (EU) No.267/2012 (“Regulation 267”) and Regulations 267 has direct application, i.e. the force of law, in the individual states of the EU. The UK has its own Iran sanctions regime beginning with an order in 2007 implementing UN Security Council Resolution 1737. The UK has also implemented the Iran (European Union Financial Sanctions) Regulations 2012 (SI 2012/925) as amended by the Iran (European Union Financial Sanctions) Regulations 2013 (SI 2013 No. 163), to give effect to Regulation 267 (as expanded) but which in some areas is broader than Regulation 267.

2.5 There are extensive and broad U.S. sanctions in place in respect of Cuba, North Korea, Sudan and Syria as well as Iran and more limited and specific sanctions in place in respect of Belarus, Burma (Myanmar), Democratic Republic of Congo, Iraq, Lebanon, Liberia, Libya, Somalia, Yemen and Zimbabwe.

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1 “U.S. persons” and “persons subject to the jurisdiction of the U.S.” are broadly defined, and include: (i) U.S. citizens, regardless of place of residence; (ii) U.S. green card holders, regardless of place of residence; (iii) U.S. residents, regardless of citizenship; (iv) entities organised under the laws of the U.S. or any state or territory of the U.S., and (v) entities having a place of business in the U.S., and depending in the sanctions regime, may include entities owned or controlled by U.S. persons.

2 See the Iran Sanctions Act (formerly known as the Iran and Libya Sanctions Act) and the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (CISADA), the National Defense Authorisation Act for Fiscal Year 2012 (NDAA), the Iran Threat Reduction and Syria Human Rights Act 2012 (ITRSHA) and the Iran Freedom and Counter-Proliferation Act of 2012 (IFCA) – the last in effect from 1st July 2013 pursuant to Executive Order 13645.
2.6 Sanctions in respect of Syria were initially imposed in May 2004 by the U.S., and these sanctions were expanded in 2006, 2008 and on multiple occasions since April 2011. Sanctions against Syria were introduced by the EU in May 2011. Initially, asset freezing measures were imposed on persons identified as responsible for the violent repression of the civilian population. The sanctions also prohibited the provision of equipment and technical assistance to Syria which might be used for internal repression (subject to some exceptions). Since then the sanctions have been amended and extended given the deteriorating human rights situation. Sanctions currently include a prohibition on the purchase, import or transportation from Syria of crude oil and petroleum products. There are also prohibitions in respect of the sale, supply, transfer and export of equipment and technology (and the financing of such equipment and technology) for the exploration, production and refining of crude oil and natural gas. The restrictive measures are currently implemented by EU Regulation 36/2012 (in force from 19 January 2012 and as further amended in 2012 and 2013) which repealed and replaced the earlier Regulation 442/2011. The U.S. sanctions against Syria are applicable to U.S. persons and to “foreign sanctions evaders”, which are defined as non-U.S. persons who take steps to evade U.S. sanctions against Syria, including attempts to conceal transactions or to facilitate deceptive transactions.

2.7 Sanctions are typically targeted at both named companies/individuals and at certain types of activity with the sanctioned country, regardless of the specific parties involved.

2.8 A further level of complexity is created by “blocking” laws which prohibit compliance with foreign sanctions. An early and well-known example is the U.S. regulation prohibiting a refusal to do business with a boycotted country (aimed, albeit not expressly, at the Arab League boycott of Israel). Council Regulation (EC) no. 2271/96 prevents EU nationals from complying with certain U.S. sanctions having extra-territorial effect and is given effect to in the UK by a statutory instrument (the Extraterritorial US Legislation (Sanctions against Cuba, Iran and Libya) (Protection of Trading Interests) Order 1996). These measures pre-date the recent spate of U.S. sanctions with extra-territorial effect (Comprehensive Iran Sanctions, Accountability and Divestment Act (CISADA), National Defense Authorization Act (NDAA) and Iran Threat Reduction and Syria Human Rights Act (ITRSHA)) and it is thought that they do not operate on those U.S. sanctions, although the issue may not be free from doubt. Germany has a law of general application (Section 4 (a) of the Aussenwirt­schaftsverordnung) which prevents German nationals from participating in trade sanctions which are not based on a UN Resolution or on binding EU legislation, e.g. some of the U.S. OFAC sanctions.

2.9 A point of contrast between U.S. and EU sanctions is the increasing tendency of the former to have extra-territorial effect (3.5 and 3.6), whereas the policy of the EU is expressly to reject extra-territoriality – and to be hostile to the extra-territorial effect of non-EU sanctions. EU sanctions typically apply to activity within the EU by anyone, activities anywhere in the world by companies or nationals of a Member State and activity involving ships or aircraft under the jurisdiction of a Member State.

2.10 A further point of contrast between the EU and the U.S. is in the field of judicial review. EU sanctions have been the subject of (often successful) challenge in the EU and the UK courts (6.5). This has not happened in the U.S. to the same extent. Although there have been some challenges to designation of specific persons to the U.S. specially designated nationals list, the decisions of OFAC in administering U.S. sanctions are given a great amount of judicial deference. U.S. courts have been reluctant to overrule decisions of OFAC unless they have been shown to arbitrary and capricious, with no basis in law.

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3 See “Guidelines – Restrictive Measures”, Council of the European Union Document 11205/12, as updated, paragraphs 51 and 52
4 See Regulation 267, Article 49
3. Approach taken by shipping financiers to sanctions issues

3.1 U.S. shipping financiers have traditionally included a sanctions clause in their documents where they have been lending or leasing to U.S. customers, i.e. customers themselves subject to U.S. sanctions. More recently, U.S. shipping financiers have been requiring all customers to comply with U.S. sanctions due to the risk of sanctions violation by the U.S. shipping financier if funds are channelled to a sanctioned person or are used in connection with a sanctionable transaction. However, U.S. financiers have sometimes encountered difficulty in having their U.S.-oriented sanctions clauses accepted by customers outside the jurisdiction of the U.S.

3.2 Shipping financiers outside the U.S. have, until recently, generally not included a specific sanctions clause in their documents. This is because they have not been subject to the longstanding and extensive sanctions culture of the U.S. The expansion of sanctions by the EU and the UK in the latter part of the previous decade, in particular the EU sanctions against Iran in 2007, sharply raised awareness. U.S. branches of non-U.S. banks (i.e. falling within the definition of “U.S. persons” for the purposes of the U.S. sanctions provisions) have, of course, included sanctions clauses.

3.3 The following general and standard provisions which are almost invariably included in documentation have a bearing on sanctions:

a. an obligation on the customer to comply with applicable laws and regulations; and
b. an event of default or mandatory prepayment/termination event if the making or maintenance of the loan or lease by the financier becomes illegal through a change of law.

Most shipping financiers regard these traditional and general provisions not to be adequately responsive to the rapid growth of sanctions in the last five years or so.

3.4 The approach to sanctions has been and continues to be reviewed by shipping financiers. Different sanction regimes apply to different financial institutions, so it is not a case of “one size fits all”. Financial institutions appear to take different approaches. Some look beyond the laws which are binding on them and seek to impose on themselves, and perhaps even their customers, compliance with wider laws. For example, an international financial institution might take the policy decision to comply, and require compliance by its customer with U.S. sanction restrictions even where such compliance is not required as a matter of law. The reasoning behind such an approach might include reputational issues, a concern about repercussions for that financial institution in the U.S. Dollar financial and currency markets or concern about ability to sell-down to U.S. financial institutions. In addition, certain U.S. sanctions against Iran are targeted at foreign financial institutions, such as the sanctions that may be applied to any foreign financial institution that knowingly conducts or facilitates significant transactions with a designated Iranian bank or the Central Bank of Iran. A growing number of U.S. sanctions against Iran target the shipping sector and marine insurance. There is increasing anecdotal evidence that a number of international financiers are indeed seeking to impose compliance by their customers with sanctions regimes, irrespective of whether the customer is legally bound by a particular regime.

3.5 Regulations implementing CISADA (2.2) highlight CISADA’s extra-territorial effect. The regulations require U.S. banks, on the request of the U.S. Financial Crimes Enforcement Network (FinCEN), to ask foreign correspondent banks to certify whether they maintain accounts for certain designated Iranian financial institutions and, if so, to provide certain further information. NDAA and ITRSHRA (2.2) also have an extra-
The term that in making the loan or lease, the financier is not financing or facilitating a territorial focus, requiring the U.S. to impose sanctions upon any foreign financial institution that knowingly conducts or facilitates significant transactions, including transactions relating to purchases of petroleum from Iran, with a designated Iranian bank or the Central Bank of Iran (unless certain conditions apply). In addition, the Iran Freedom and Counter-Proliferation Act (IFCA) (2.2) imposes sanctions upon any person providing insurance, reinsurance or underwriting services for any sanctioned activity with respect to Iran, expressly mentioning shipping as a “sanctioned activity.” The prohibitions contained in IFCA are not limited to U.S. persons but are expressly targeted to have an extra-territorial focus, as U.S. persons have been prohibited from providing insurance with respect to shipping to or from Iran for many years.

3.6 The determination of the U.S. government to enforce compliance with U.S. sanctions by non-U.S. persons is further shown by the Executive Order of May 1 2012 which targets non-U.S. persons which have “violated, attempted to violate, conspired to violate, or caused a violation of [U.S. sanctions against Iran or Syria]” or “facilitated deceptive transactions for or on behalf of any person subject to United States sanctions covering Iran or Syria”. The penalty for being found to be a “foreign sanctions evader” is a broad prohibition on U.S. persons trading with such a person.

3.7 Most financiers are now expecting to see language in their documentation which expressly addresses sanctions. As noted in 3.4, the tendency seems to be towards more comprehensive and restrictive language. This is to a large degree a reaction to the ever-increasing scope and reach of U.S. sanctions directed at Iran (see 6). Apart from the issues referred to in 3.4, there is a possible legal argument for requiring compliance in English law financing documents with U.S. sanctions.6

4. Sanctions and shipping: particular issues

4.1 Financiers subject to a sanctions regime will need to address at least the following broad issues (subject to the wording of the applicable sanctions):

a. that the customer to whom they are considering lending or leasing (and persons controlling it or which it controls) is not a prohibited/designated person nor acting on behalf of a prohibited person at inception;
b. that the customer complies, and will continue to comply, with sanctions which are applicable to it and its business;
c. that in making the loan or lease, the financier is not financing or facilitating a sanctioned activity; and
d. an exit mechanism for the financier if the customer becomes sanctioned or engages in a sanctioned activity.

4.2 The issues at 4.1(a) and (b) are relatively uncontentious but it should be noted that:

a. in relation to 4.1(a), a customer which is initially not sanctioned might become so by reason either of new sanctions or a change in its control – hence the need for 4.1(d); and
b. in relation to 4.1(b), there can be difficulty where the financier is subject to a sanctions regime to which its customer is not subject. A customer might be reluctant to represent or undertake to its financier that it will bind itself and its operations to compliance with a sanctions regime by which it, the customer, is not legally bound. However, the trend identified in 3.4 should be noted in this context.

4.3 The issue at 4.1(c) is addressed in the first instance by the purpose clause in the loan agreement. Where the purpose of the loan is to finance the acquisition of a specific ship or

6 See 4.10 and the comment by Blair J in Sea Glory Maritime Co. and another v Al Sagr National Insurance Co. [2013] EWHC 2116 (Comm) at paragraph 302. However, the issue should not be overstated. This brief comment was ‘obiter’, ie not necessary as part of the decision and it goes beyond the generally accepted view that for an English law contract to be unenforceable under English common law by reason of foreign illegality there has to be performance of the contract in the relevant foreign country (see also Article 9(3) of the Rome I Regulation – Regulation (EC) No. 593/2008). It is also uncertain whether foreign laws having extra-territorial effect fall within the scope of the English common law rule.
newbuilding the position is clear. There is less clarity in relation to a facility for general corporate purposes or a revolving credit facility.

4.4 In relation to 4.1(d), it should be borne in mind that for a financier to accept funds following either a mandatory prepayment event or an enforcement following an event of default, in either case triggered by sanctions issues, a consent or licence from a competent authority might be required.7

4.5 The nature of the shipping industry gives rise to concerns about the possibility of indirect facilitation of a sanctioned activity. Ships can trade worldwide, often with no established trading pattern (depending on the type of ship and trade). Shipowners enter into time charters or contracts of affreightment, the effect of which is that the owner remains responsible for operation of the ship but is required to trade it in accordance with the directions of the time charterer or to comply with the contract of affreightment. There can be chains of charters and sub charters. Charterers and sub-charterers might be subject to different sanctions regimes from the owner and the owner’s financier, or not subject to sanctions regimes at all. The drafters of sanctions are aware of this issue but appear not to be sympathetic to the position of the shipowner. Article 37b of EU Regulation 267 prohibits not only the making available of oil or petrochemical tankers to any Iranian person, entity or body but also the making available “to any other person, entity or body, unless the providers of vessels have taken appropriate action to prevent the vessel from being used to carry or store oil or petrochemical products that originate in Iran or have been exported to Iran”. Guidelines issued by the U.S. State Department in 2011 urged shipping and insurance companies in particular “to minimise their exposure to the Iranian energy sector and to exercise as much due diligence as possible in doing business, directly or indirectly with Iranian entities” and gave the following as one of the examples of potentially sanctionable activity under CISADA (which has extra-territorial effect): “Charter of a ship to another company that is using the ship to supply Iran with gasoline, diesel, jet fuel, or aviation gasoline. The shipowner may still have engaged in sanctionable activity even if it does not have full control of the ship under the charter agreement.” All this points to the need for shipowners to exercise due diligence and impose contractual restrictions on charterers.

4.6 The Baltic and International Maritime Council (BIMCO) has developed a sanctions clause for charters which is favourable to shipowners and which gives them the right to refuse to comply with charterers’ instructions where this would put the shipowner in breach of sanctions and contains an indemnity by the charterer in favour of the shipowner in respect of claims by cargo interests or sub-charterers by reason of the shipowner exercising its rights under the clause. More recently, BIMCO has also published a “designated entities” clause. Whereas the sanctions clause addresses trading activity the designated entities clause addresses the risk of a party being a sanctioned entity and has the shipowner and charterer warrant to each other that they are not. Significantly, in the case of the charterers, this warranty extends in the case of sublet to “any sub-charterers, shippers, receivers, or cargo interests” and so addresses the issue referred to at 4.5.

4.7 Financiers have a commercial interest in the employment of a vessel; standard undertakings in loan and security documents require information to be delivered by the customer, sometimes automatically and sometimes at the request of the financier. Bareboat chartering, and time chartering for longer than a specified period, invariably require financier consent. This, coupled with a “know or reason to know” standard under U.S. law and a “reasonable cause to suspect” standard under EU Regulation 267, means that it might be hard for financiers legitimately to plead a “blind eye” defence, even for sanctioned activity which is not contemplated at the inception of the transaction but which arises in the future under a charter or sub-charter.9
4.8 Sanctions are increasingly directed specifically at shipping. The most effective way to stop sanctioned shipping activity is to cut off the availability of insurance cover, in particular P&I cover, and classification services. Sanctions directed at Islamic Republic of Iran Shipping Lines (IRISL) and then National Iranian Tanker Company (NITC) were effective to prevent them obtaining P&I cover in the international markets.10 More recent U.S. and EU sanctions address insurance specifically. The awareness of insurers to issues presented by sanctions is now acute. It is common practice for a sanctions limitation and exclusion clause (such as the Lloyds Market Association 3100 Sanction Limitation and Exclusion Clause) or a sanctions cancellation clause to be included in policies. In a 2011 case a notice of cancellation by EU insurers in reliance on a sanctions cancellation clause and EU Regulation 961/2010 was held to be valid so as to deny cover to an Iranian-controlled shipowner.11 The International Group of P&I clubs has published a “FAQ” paper on Iranian sanctions issues. See also 6.4.

4.9 The appearance of sanctions limitation and exclusion clauses or sanctions cancellation clauses in insurances and the possibility of sanctions issues otherwise vitiated insurance cover pose an obvious risk to financiers. To what extent does MII cover respond to this risk? In principle it can. However, if the shipowner’s policy is cancelled pursuant to a sanctions cancellation clause (subject to required notice of cancellation being given to the mortgagee pursuant to its letter of undertaking) the MII policy might not cover the mortgagee. The MII policy might cover the mortgagee where the shipowner trades in breach of a sanctions warranty in its insurances and might also cover the mortgagee against the effect of a sanctions limitation and exclusion clause in the shipowner’s policy – as long as the mortgagee is not privy to the breach of warranty or other sanctioned activity by the shipowner.12 In any event, the wording of both the shipowner’s policy and the MII policy will also be crucial.

4.10 The alertness of insurers to sanctions issues is shown by a recent case where, without any express sanctions limitation and exclusion clause in the policy, the insurers (unsuccessfully) tried to deny cover.13 U.S. Dollar freight payments under bills of lading issued to an Iranian shipper were held to involve a violation of U.S. sanctions by the processing bank and also a violation by the shipowner in causing a violation by the processing bank. The vessel became a constructive total loss through fire some time after the contentious employment. The insurers claimed, among other things, that the breach of U.S. law by the shipowner meant that the English law insurance contract was tainted by illegality so as to enable them to deny cover. This was rejected by the court. The main points arising from the case as regards sanctions and insurance are as follows:

a. the warranty of legality under Section 41 Marine Insurance Act 190614 was not breached because the payment of freight was not part of the “adventure” within the meaning of the Section;
b. the warranty under Section 41 related to lawfulness under English law only;
c. the principle of English common law that an English law contract can be unenforceable by reason of illegality under foreign law did not apply on the facts of the case because there was no causal link between the illegality and the claim under the policy;
d. based on expert evidence on U.S. law a broad interpretation would be given to “facilitating” under U.S. sanctions law.

The result of the case is not surprising on the facts. It was not unlawful under U.S. law (or any other law) at the time for the shipowner to trade with Iran. However, a comment of the judge15 in relation to the issue at (c) should be noted: “It would be different in my view if at the time of entering into the policy, the assured intended to perform the adventure in a manner which involved a breach of U.S. law”.

10 In a case in 2010 – Islamic Republic of Iran Shipping Lines v Steamship Mutual Underwriting Association (Bermuda) Limited [2010] EWHC 2661 (Comm) – a P&I club argued that pre-existing coverage had been discharged by frustration or supervening illegality due to an order issued by HM Treasury pursuant to the Counter-Terrorism Act 2008 which designated IRISL (and Bank Mellat). On the facts, which included the granting of the P&I Club of a license by HM Treasury, the argument was unsuccessful and cover was upheld.
11 Arash Shipping Enterprises Company Limited v Groupama Transport [2011] EWCA Civ 620
12 This is a complex issue and beyond the scope of this memorandum.
13 Sea Glory Maritime Co and another v Al Sega National Insurance Co. [2013] EWHC 2116 (Comm)
14 “There is an implied warranty that the adventure insured shall be a lawful one, and that so far as the assured can control the matter, the adventure shall be carried out in a lawful manner”.
15 At paragraph 302 of the judgement. However, see footnote 6 for some context.
4.11 Inability to obtain insurance cover was one of the circumstances which led to the arrest in Singapore by financiers in September 2010 of three containerships owned by German entities controlled by IRISL. The vessels were released by order of the High Court of Singapore in late January 2011 following payment by the owners to the financiers of the secured debt on the grounds that (perhaps surprisingly) the entities in question were not caught by the Singapore sanctions regime. Having made that finding, which effectively disposed of the issue, the judge went on to make some further observations about the treatment of the vessels had the owners been found to be subject to the Singapore sanctions regime. The judge’s view was that the UN Resolutions on Iran sanctions and also the EU and UK sanctions regimes did not require vessels owned by sanctioned entities to be impounded or detained. However, the background to the case indicates the following potential problems for financiers, which might require consents or licences to be sought where available, prior to enforcing security against vessels owned by entities which have become sanctioned:

a. receiving payment from the sanctioned customer (in the “Sahand” case payment in full was made by the customer and the necessary licenses were obtained by the financiers);
b. how any sanctions regime in the jurisdiction of enforcement and/or any sanctions regime by which the financier is otherwise bound treat the judicial sale process and payment of sale proceeds to the financier; and
c. whether potential bidders for vessels in a judicial sale (including protective bidders supported by the mortgagee) would be prevented from bidding by sanctions regimes by which they are bound.

4.12 The plight of the Indian tanker “Desh Shanti”, as reported in August 2013, demonstrates the effect of sanctions directed at marine insurance. It was arrested in Iran for allegedly spilling oil in Iranian waters. Its P&I club (Steamship Mutual) would have been unable to make any payment or provide any guarantee to secure its release (without a license from the competent authority). It now appears from reports that the vessel has been released – with suggestions of diplomatic moves between India and Iran rather than a response from the P&I club.

4.13 In passing, it is worth comparing and contrasting the position outlined above in relation to the shipping industry with the position in the aviation industry...

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16 The “Sahand” and other applications [2011] 5 GHC 27.
17 But see the English case footnoted at 4.4.
ships happens all the time; and
e. the flight pattern of aircraft is constrained by regulatory requirements and is often more predictable than the trading pattern of ships (at least ships which are not servicing a liner trade).

5. Different sanctions regimes
5.1 An international financial institution, with branches in many different jurisdictions, will potentially be subject to different sanctions regimes. A particular branch or subsidiary might be bound by a sanctions regime or regimes which are not binding on other branches or subsidiaries.

5.2 It should be noted, however, that the U.S. sanctions regime has a “long arm” approach and has been applied to banks where the only connection with the U.S. was that U.S. Dollars were involved through the New York clearing system. Under NDAA and ITRSHA, foreign financial institutions face restrictions on, or loss of, correspondent and payable-through account access in the United States if they knowingly engage in significant financial transactions with the Central Bank of Iran or a designated Iranian financial institution (unless certain narrow exemptions apply).

5.3 Different sanctions regimes apply different tests as to state of knowledge or awareness, i.e. whether only actual knowledge is sufficient to establish culpability or whether one form or another of constructive knowledge is sufficient. Under U.S. law, financiers have certain “know your customer” obligations, and if a financier knows or has reason to know that customer is engaged in sanctioned activity or intends to engage in sanctioned activity, the financier can be held to be in violation of sanctions if the financier proceeds with the transaction. See 4.7.

5.4 Where a financier and its customer are subject to the same sanctions regime – say that of the EU – it should be easy to agree sanctions language. More difficulty can arise where the financier and customer are subject to different sanctions regimes – or where the customer is not subject to any sanctions regime at all. For the financier, the cautious approach is to require the customer to comply with all sanctions regimes binding on the financier in addition to those (if any) binding on the customer. However, this might be difficult for the customer to accept. If the customer resists the financier then has to consider carefully, based on the terms of the sanctions regime by which the financier is bound, if not doing so puts the financier at risk of sanctions breach. (In this context, use of expressions such as “directly or indirectly”, “knowingly” and “facilitate” in sanctions laws require careful attention). See 4.7 and also the issues referred to at 3.4 and 3.7.

5.5 The difficulties caused by anti-sanctions blocking laws should be borne in mind (see 2.8).

5.6 Many EU and UK sanctions allow what would otherwise be sanctioned activity to be licensed by the competent authority (HM Treasury in the case of the UK). As regards U.S. sanctions, the Office of Foreign Assets Control (OFAC) can issue licences that grant permission to engage in activity that would otherwise be subject to sanctions. Licences, however, are generally issued only for humanitarian items and are issued only to persons to whom the sanctions would be applicable i.e., generally, U.S. persons. (This latter point means that if a financier imposes U.S. sanctions restrictions on a customer who is not bound by them that customer is not able to apply for a licence).

“For the financier, the cautious approach is to require the customer to comply with all sanctions regimes binding on the financier in addition to those (if any) binding on the customer. However, this might be difficult for the customer to accept.”
6. Iran Sanctions

6.1 The application of different and extensive sanctions regimes to Iran – and the importance of Iran in the export of crude oil – mean that Iranian sanctions are going to be a main but not exclusive focus of any shipping financier. The scope and effect of Iranian sanctions can be seen from what is written in 4.

6.2 The scope of sanctions imposed by the U.S., the EU and the UK can be seen from the following (and this is not a complete list):

a. with limited exceptions, as a matter of EU law it is prohibited (i) to import crude oil, petroleum products or petrochemicals into the EU if they originate in Iran or have been exported from Iran, (ii) to purchase crude oil, petroleum products or petrochemicals which are located in or which originated in Iran and (iii) to transport crude oil, petroleum products and petrochemicals if they originate in Iran or are being exported from Iran to any other country. EU nationals are also prohibited from providing, directly or indirectly, financing or financial assistance, including financial derivatives, as well as insurance and reinsurance related to the import, purchase or transport of crude oil, petroleum products and petrochemicals of Iranian origin or that have been imported from Iran;

b. with limited exceptions, as a matter of EU law, there are financing and investment restrictions affecting loans, participations and joint ventures with Iranian persons, entities or bodies involved in the oil, gas and petrochemical industry;

c. the supply of specified goods and technology (broadly, telecommunications or nuclear goods and technology, and equipment capable of being used for internal repression) to any Iranian person, entity or body or for use in Iran is prohibited by the EU and the UK sanctions regimes;

d. any trading by U.S. persons with Iran or in Iranian originated goods is prohibited under U.S. sanctions;

e. financing of designated Iranian entities is prohibited under the U.S., EU and UK sanctions regimes;

f. with limited exceptions, there are asset freezes in place against the Central Bank of Iran and Bank of Tejarat as a matter of EU law;

g. importing to Iran technology for the exploration, production and refining of crude oil and natural gas or for use in the petrochemical industry is prohibited by the EU sanctions regime;

h. importing refined petroleum products into Iran (and related activities including providing shipping services or insurance) is prohibited for U.S. and non-U.S. persons by CISADA;

i. the purchase of petroleum or petroleum products from Iran by any person (except for deliveries to countries that received an exemption from OFAC due to reduction of any purchases from Iran) is subject to sanction by the U.S.;

j. financial institutions that knowingly conduct or facilitate significant transactions with a designated Iranian financial institution or the Central Bank of Iran are subject to U.S. sanctions (with certain exemptions); and

k. attempting to conceal sanctionable activities or to evade sanctions is subject to U.S. sanctions.

6.3 The extension of EU sanctions to the export and transportation of Iranian crude oil, petroleum products and petrochemicals has introduced a new dimension to the issues facing the international shipping industry; see 6.2(a). Regulation 267 became binding under EU law on 24 March 2012 with certain exceptions for existing contracts concluded before 23 January 2012. Those exceptions ceased to apply on 1 May 2012 in respect of petrochemical products and on 1 July 2012 in respect of crude oil and petroleum...
products. Significantly, Regulation 267 specifically prohibits EU parties from providing “directly or indirectly, financing or financial assistance, including financial derivatives, as well as insurance and re-insurance related to the import, purchase or transport of crude oil and petroleum products [or petrochemical products] of Iranian origin or that have been imported from Iran”. There were exceptions for third party liability insurance and environmental liability insurance but these exceptions ceased to apply on 1 May 2012 in respect of petrochemical products and on 1 July 2012 in respect of crude oil and petroleum products. Now, only non-EU shipowners can transport the relevant cargoes to non-EU destinations – and will need to insure through non-EU insurers. (It is generally thought that the prohibitions apply not just to cargoes but also to bunkers of Iranian origin). The effect of Article 37b of Regulation 267 on chartering should also be noted in this context (see 4.5).

6.4 The U.S. sanctions directed at Iran become ever more extensive. Note the extra-territorial effect of CISADA, NDAA and ITRSHA. On 1st July 2013 a further set of sanctions under IFCA came into force specifically targeting insurance of sanctioned activity and having extra-territorial effect. At the same time the New York State Department of Financial Services (NYDFS) sent a letter to certain non-U.S. reinsurers requesting compliance information. It has been reported in August 2013 that Lloyd’s of London has asked its members and managing agents to carry out a sanctions review, no doubt partly in response to the NYDFS action. In February 2013 the SEC introduced rules requiring foreign U.S. listed companies to disclose information on trading with Iran – whether or not activity is sanctioned.

6.5 As the sanctions net has become tighter in relation to Iranian shipping, attempts have been made by Iranian shipping interests to get around sanctions, notably reflagging to often exotic or obscure jurisdictions – now mostly stopped through international/U.S. pressure on those nations – and setting up insurance companies. There have also been challenges by Iranian sanctioned companies and individuals in the UK and EU courts. More worryingly for financiers and shipping companies there undoubtedly has been and will continue to be attempts by Iranian interests to circumvent sanctions by disguising ownership in the context of chartering and ship sale and purchase. In this context it should be noted that EU sanctions frequently contain anti-circumvention provisions prohibiting activity with a view to “getting around” sanctions.

6.6 Borrowers have claimed to be relieved from obligations by Iranian sanctions but the English courts have shown themselves to be unsympathetic to opportunistic attempts to rely on sanctions. In two recent cases it has been held that contractual obligations are not discharged by the doctrine of frustration or by illegality where it would be possible for the obligations to be performed if an appropriate license were obtained. In the first case, a borrower unsuccessfully argued that it was relieved from its obligations to pay fees to a sanctioned Iranian bank. In the second case, a sanctioned Iranian shipping company unsuccessfully argued that it was relieved from its obligation to repay a loan. It was also held in that case that a loan is not an “economic resource” as far as the borrower is concerned for the purpose of the relevant sanctions and so repayment was not frozen. Crucially, in each case the borrower could perform its obligations lawfully subject to obtaining a license from the competent authority.

“As the sanctions net has become tighter in relation to Iranian shipping, attempts have been made by Iranian shipping interests to get around sanctions...”

19 See the cases footnoted in 4.8. Dramatically, in a landmark decision on administrative law, the HM Treasury Order which was at issue in the case between IRISL and Steamship Mutual has been held by the Supreme Court to be unlawful as regards its application to Bank Mellat (Bank Mellat v Her Majesty’s Treasury (No. 2) [2013] UKSC 39). Iranian companies and individuals have also been active in taking legal action in Europe against EU Sanctions. In September 2013 a number of EU Iranian sanctions were successfully challenged in the EU’s General Court in Luxembourg by various parties – including IRISL and certain related parties.

20 For example, see Regulation 267, Article 41.
21 Mellli Bank plc v Holbud Limited [2013] EWHC 1506 (Comm)
22 DVB Bank SE and others v Shere Shipping Company Ltd and others [2013] EWHC 2321 (Comm)
7. Some conclusions and issues to address

7.1 A financial institution engaged in shipping finance will need to address the issues presented by sanctions on its shipping finance activities in the context of its overall compliance requirements and its approach to sanctions generally.

7.2 As a threshold issue, the sanctions regimes which apply to the financial institution in each of the jurisdictions from which it engages in shipping finance need to be established. The type of entity (branch or subsidiary) and the nationality of the individuals involved are relevant. Apart from the legal requirements, any general policy which the financial institution has of broader sanctions compliance should be confirmed.

7.3 For both existing and other transactions, the sanctions regimes by which the shipping company is bound (and any broader policy of sanctions compliance) should be checked.

7.4 The existing portfolio should be reviewed for transactions which might have become sanctioned. If any such transactions exist, the outcome under the documentation and the possibility of obtaining a licence to continue the transaction should be considered.

7.5 Where existing transactions are being amended, or waivers requested by the customer, financiers should consider a sanctions “health-check” and take the opportunity to require sanctions compliance language which might not have been present in the original documents. In extreme cases, such a check could reveal the customer to be carrying on a sanctioned activity, making it inadvisable for the financier to agree to an amendment or grant a waiver if the sanctioned activity continues.

7.6 For new transactions:
   a. KYC and pre-transaction due diligence as regards the customer and also the intended use of the vessel will need to focus on sanctions issues;
   b. consideration should be given to requiring sanctions-specific representations and undertakings;
   c. sanctions issues should be addressed at the term sheet stage and not left to the documentation stage.

7.7 The undertakings relating to chartering and employment and the restrictions (or lack of restrictions) should be reviewed. This applies to both existing and new transactions. Sanctions issues should be borne in mind when financiers are reviewing and approving charters – either at inception of a financing or during the term of a financing.

7.8 The role of banks in ship sale and purchase transactions as deposit holder can give rise to potential sanctions-related issues.

7.9 It is assumed that financiers will already have in place filtering mechanisms to address prohibited payments to or from sanctioned sources.

7.10 Whilst wording templates can be developed the documentary requirements for particular transactions might need to be bespoke – and the possibility of push-back from customers – and how to respond to it – needs to be considered.

7.11 The relationship between sanctions language and syndication/sell-down needs to be considered. For example, absence of language addressing U.S. sanctions requirements could deter U.S. financiers from coming into a transaction. However, the blocking provisions referred to in 2.8 should be noted in this context.

“... financiers should consider a sanctions ”health-check” and take the opportunity to require sanctions compliance language which might not have been present in the original documents.”
8. Contacts

Should you wish to discuss any of the matters raised in this briefing, please speak with the authors, David Osborne and Jane Freeburg-Sarma, a member of our team below, or your regular contact at Watson, Farley & Williams.

David Osborne  
Partner  
London  
dosborne@wfw.com  
+44 20 7814 8152

Jane Freeburg-Sarma  
Associate  
New York  
jfreeberg-sarma@wfw.com  
+1 212 922 2218

Daniel Rodgers  
Partner  
New York  
drogers@wfw.com  
+1 212 922 2206

Mei Lin Goh  
Partner  
Singapore  
mlgoh@wfw.com  
+65 6551 9125

Jesse Clark  
Associate  
Singapore  
jclark@wfw.com  
+65 6551 9187

Madeline Leong  
Partner  
Hong Kong  
mleong@wfw.com  
+852 2168 6710

Maren Brandes  
Partner  
Hamburg  
mbrandes@wfw.com  
+49 40 8080 3440

George Paleokrassas  
Partner  
Piraeus  
gpaleokrassas@wfw.com  
+30 210 455 7301

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