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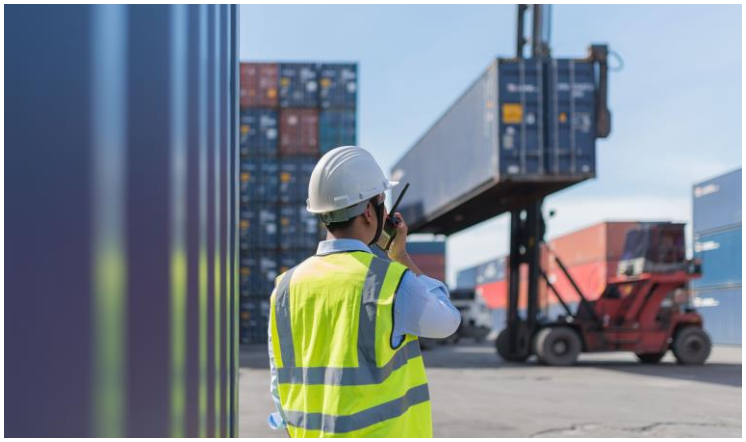
SANCTIONS AND SHIPPING – UPDATE AND OVERVIEW



OCTOBER 2020

EXECUTIVE SUMMARY

This report highlights some recent developments and forthcoming changes in the sanctions landscape. They are developments and changes which will increase the importance of compliance, most likely complicate the task and which have particular relevance for the maritime industry.

- The use of sanctions as a foreign and security policy tool has led to a proliferation of sanctions regimes. These sometimes have conflicting requirements. However, they use broadly the same tools: prohibitions or restrictions on trading, exports and imports and freezing and blocking of funds, and it is this that makes them of particular relevance to shipping, which is at the heart of world trade.
- The US and UK authorities recognise this. Compliance by the shipping industry is essential to the effectiveness of sanctions regimes. It is no surprise therefore that in recent months both the relevant US and UK authorities have issued "guidance" to the maritime industry.
- The guidance from both the US and UK authorities, although different in tone, focus on the recognition of illicit practices and the measures required or suggested to ensure compliance.
- This guidance requires careful consideration and it comes at a time when the sanctions landscape is changing.
- To date, for reasons explained in this briefing, the principal sanctions regimes for those operating in international markets have been those of the US and the EU. The position will be changed and complicated by the UK's departure from the EU.
- From the end of the Brexit transition period, EU sanctions will cease to be applicable in the UK and its own regime will take effect under the Sanctions and Anti-Money Laundering Act 2018 (SAMLA).
- The UK regimes (like the EU regimes) will have extra-territorial effect in some respects and will not apply only to UK persons - see further below on this.
- SAMLA includes extensive provisions empowering the imposition of sanctions affecting shipping. The principal provisions are summarised in this briefing. Not surprisingly, these too have extra-territorial effect.
- As a result of the potential extra-territorial application of the EU and UK regimes, in some cases both the EU and UK regimes will apply. In these instances it will therefore be necessary to check the UK regime in addition to the EU regime.
- In some cases they will have differing provisions and it will be necessary to comply with both. If there are not just differences, but conflicts, complex issues will arise.
- Similar complexities have existed for decades resulting from the application of US sanctions - and in this briefing we summarise the differing mechanics of US primary sanctions, secondary sanctions and their extra-territorial effect. However, the Trump Administration has dramatically expanded the use of secondary sanctions and the EU has enhanced its anti-boycott legislation leading to the real possibility of conflicting requirements where it is not possible to comply with both.
- Against this background of increasingly complex sanctions regulation and ever closer attention by the relevant authorities, it will be important to have a full understanding of the sanctions applicable to the business, the risks posed in the relevant activity and the due diligence and compliance measures required to address those risks. In the context of specific transactions, the contractual terms should be tailored to manage the risks.

RECENT DEVELOPMENTS, FORTHCOMING CHANGES AND THE NEED FOR COMPLIANCE

Sanctions and the maritime industry

Compliance with sanctions has long been a high priority and a complicated matter for entities involved in the maritime industry.

There are a number of reasons for this. The use of sanctions as a foreign and security policy tool, in particular by the US, EU and UK, has increased considerably in recent years and this trend continues. This has led to a proliferation of sanctions regimes. These regimes may have sometimes conflicting requirements (see below) but they largely employ the same tools: partial or blanket prohibitions on trading with certain countries, restrictions on the export or import of various goods, restrictions on the transfer of certain technologies and asset freezes. It is therefore inevitable that they have a particular significance for shipping and that those involved in the sector are particularly exposed to the risk of sanctions violation. Ships trade worldwide, often with varying trading patterns. The contractual chain, from lenders or lessors through charterers and sub-charterers to cargo interests may be long and there is often no direct contractual nexus between all parties in the chain. Sanctionable activities may be difficult to detect and may be disguised by illicit practices.

The US and UK authorities recognise both that compliance by the shipping industry is essential to the effectiveness of sanctions regimes and that shipping is susceptible to would be sanctions evaders. It is no doubt partly for these reasons, even if in differing measures, that in the past few months, the US Department of State, US Department of the Treasury's Office of Foreign Assets Control (OFAC), and US Coast Guard issued a joint Sanctions Advisory for the Maritime Industry (the "US Advisory"), which built on and expanded several prior sanctions advisories for the maritime community issued in 2018-19. Shortly thereafter the UK Office of Financial Sanctions Implementation (OFSI) issued its Maritime Guidance for entities and individuals operating within the maritime shipping sector – see further below on these measures.[1]

All the above issues go to the complexity of ensuring compliance. Notwithstanding the complexities, the potential consequences of non-compliance can be draconian, including criminal liability (and imprisonment), significant fines, exclusion from the US banking system and reputational damage.

Set in this context, we look at:

- The likely implications of the UK's autonomous sanctions regime coming into effect at the end of the Brexit transition period;
- The recent US and UK authorities' focus on shipping;
- The extra-territorial effect of certain sanctions; and
- Complications in compliance.

[1] Sanctions Advisory for the Maritime Industry, Energy and Metal Sectors, and Related Commodities - https://home.treasury.gov/system/files/126/05142020_global_advisory_v1.pdf and OFSI - Maritime Guidance: Financial Sanctions Guidance for entities and individuals operating within the maritime shipping sector – https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/903901/OFSI_-_Maritime_guidance__July_2020_.pdf

The existing regimes and a new regime

To date, for entities operating in the international markets, the four principal sanctions regimes to consider have been those of the UN, US, EU and UK.[2]

In practice, this has meant primarily the US and EU regimes. The UN regimes are enacted by the EU (which also enacts autonomous sanctions). EU sanctions (both those implementing UN sanctions and its autonomous sanctions) have a direct effect in all Member States, including the UK, and while the UK has had powers to impose its own autonomous sanctions, there have been relatively limited autonomous UK measures to date with UK legislation being primarily concerned with setting out the penalties for breaches of the EU regimes.[3] As a result, to date, UN and UK sanctions could, in general, be ascertained by reference to EU sanctions and, on the other side of the coin, most sanctions in the UK have derived from UN and EU sanctions.

This position is in the process of, possibly fundamental, change.

When the UK joined the EU by signing the Treaty of Accession in 1972, it enacted the European Communities Act (ECA). This provided for the incorporation into UK law of directly applicable EU law. Following the Brexit vote, the UK enacted the European Union (Withdrawal) Act 2018 (EUWA) and the European Union (Withdrawal Agreement) Act 2020, pursuant to which the ECA was repealed on exit day (31 January 2020) subject to certain savings provisions effective until the end of the transition period (31 December 2020).

As a result of the above, with effect from 1 January 2021, EU sanctions (amongst other EU laws) will generally cease to apply in the UK in their current form.

The Sanctions and Anti-Money Laundering Act 2018

In order to cover the position, the UK enacted the Sanctions and Anti-Money Laundering Act 2018 (SAMLA) which is enabling legislation empowering the UK government to impose a wide array of sanctions.

SAMLA confers the power to create six types of sanctions for 11 purposes.

The types of sanctions that may be imposed are: financial sanctions, immigration sanctions, trade sanctions, aircraft sanctions, shipping sanctions (see below) and sanctions for purposes of meeting UN obligations.[4]

The purposes for which they may be created are compliance with a UN obligation, compliance with any other international obligation, or where an "appropriate Minister" considers that the imposition of sanctions would achieve one of nine other specified purposes and it is these nine purposes which give the power to create an independent sanctions regime in addition to "replicating" the EU regime.[5]

The nine other purposes are: (a) the prevention of terrorism, in the United Kingdom or elsewhere, (b) the interests of national security; (c) the interests of international peace and security; (d) furthering a foreign policy objective of the government of the UK; (e) promoting the resolution of armed conflicts or the protection of civilians in conflict zones; (f) providing accountability for or being a deterrent to gross violations of human rights, or otherwise to promote compliance with international human rights law, or respect for human rights; (g) promoting compliance with international humanitarian law; (h) contributing to multilateral efforts to prevent the spread and

use of weapons and materials of mass destruction; and (i) promoting respect for democracy, the rule of law and good governance.

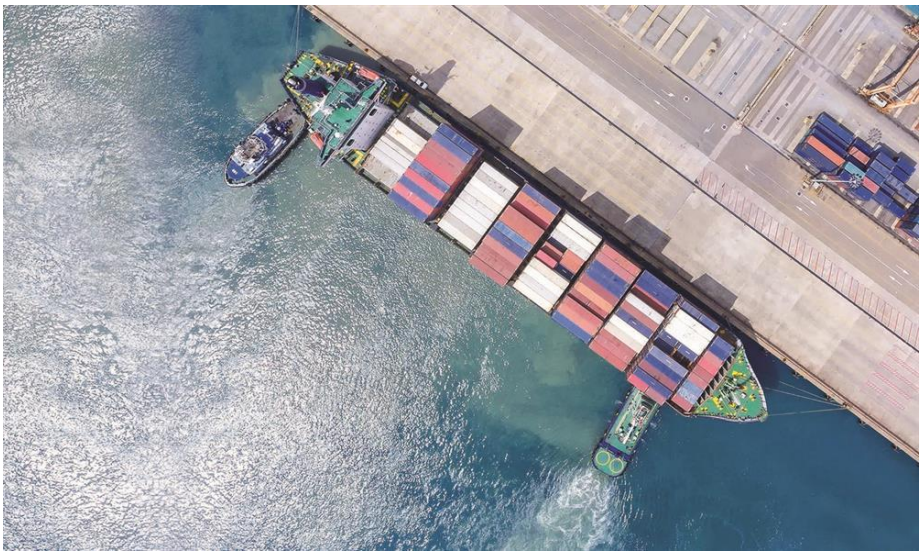
Two points to note, which we return to further below, are that:

- while one of the main purposes of SAMLA was to enable sanctions to continue uninterrupted after the end of the Brexit transition period, it does not follow that the provisions which thereafter apply will be exactly the same as those currently in force; and
- SAMLA has extra-territorial effect in a number of respects and is therefore not just of significance to the UK.

When will the changes apply?

Although SAMLA was enacted in 2018 and the majority of its provisions came into effect on 22 November 2018, it did not bring immediate changes and we are now approaching the date when the changes it will bring will come into effect. This is because SAMLA is essentially enabling legislation empowering the government to impose sanctions; it does not impose sanctions itself but empowers sanctions to be made by secondary legislation.

Some autonomous sanctions have already been brought into effect – The Global Human Rights Sanctions Regulations 2020 - however, the numerous statutory instruments which have been laid under SAMLA to transfer EU sanctions into UK law will not come into effect until 1 January 2021.



What is the position now and what will it be when the changes apply?

The current position is that we are in the implementation period. This commenced on 31 January 2020 and expires on 31 December 2020. During this period, EU

[2] It is of course also necessary to check any other sanctions regimes that may apply to the parties by reference to the location and nature of a particular activity.
[3] It should be noted that UK implementing measures can be more extensive than the EU measures and accordingly it is necessary to consider both the EU measures and the UK implementing measures.
[4] S.1(5) SAMLA
[5] Ss. 1(1) and 1(2) SAMLA

sanctions continue to be directly applicable in the UK and therefore both EU and UN sanctions continue to be implemented in this manner. Additionally, the UK can enact autonomous sanctions and, as referred to above, it has already done so in the form of The Global Human Rights Sanctions Regulations 2020.

As the law currently stands, at the end of the implementation period (from 1 January 2021), EU sanctions will cease to be directly applicable in the UK and the UK will be free to transfer the EU regulations into UK law subject to such variations as it chooses. For this purpose, as noted above, the government has already laid legislation before Parliament under SAMLA to provide for the transposition of a number of the EU regimes and these will come into effect on 1 January 2021.

The regimes covered to date include those in respect of: Belarus, Bosnia and Herzegovina, Burma (Myanmar), Burundi, Central African Republic, Democratic People's Republic of Korea, Democratic Republic of the Congo, Guinea, Guinea-Bissau, Iran (human rights), Iran (nuclear), Iraq, Lebanon, Lebanon (Assassination of Rafiq Hariri and others), Mali, Nicaragua, Russia, Somalia, South Sudan, Sudan, Syria, Venezuela, Yemen and Zimbabwe.[6]

While the government has said that there will be no gaps in implementing the sanctions regimes after the implementation period, the position will not be a straightforward matter of checking whether there is an "equivalent" SAMLA regime to the previous EU regulations. Sanctions reviews following 1 January 2021 will necessitate:

- Checking if there are (new) SAMLA regulations covering the relevant regime. If there are, these will need to be carefully reviewed to ascertain if they are the same as the existing EU regime. In its publication "Sanctions Policy after 31 December 2020", the government cautions: "Do not assume that all aspects of existing EU sanctions will be exactly the same".[7] As detailed below, it is clear that all aspects will not be the same.

- If the UK government has not yet made new SAMLA regulations to replace an EU sanctions regime by 11pm on 31 December 2020, it will be necessary to refer to the EU regulations retained under the EUWA and to check whether they have been modified under that Act.[8]

[6] https://www.gov.uk/government/collections/uk-sanctions-regimes-under-the-sanctions-act
[7] https://www.gov.uk/government/publications/sanctions-policy-after-31-december-2020/sanctions-policy-after-31-december-2020
[8] https://www.gov.uk/government/publications/sanctions-policy-after-31-december-2020/sanctions-policy-after-31-december-2020

TERRITORIAL SCOPE AND EXTRA-TERRITORIAL APPLICATION OF SAMLA

Territorial scope

SAMLA extends to England and Wales, Scotland and Northern Ireland. Any provision of it, or regulations made under it, may, by Order in Council, be extended, with or without modifications, to any of the Channel Islands, the Isle of Man or any of the British Overseas Territories (see below).[9]

Extra-territorial application

Prohibitions or requirements under SAMLA may be imposed in relation to:

- conduct in the United Kingdom or in the territorial sea by any person;
- conduct elsewhere, by a United Kingdom person.

For these purposes, *"United Kingdom person"* means –

- a United Kingdom national, or
- a body incorporated or constituted under the law of any part of the United Kingdom or, if specified by Order in Council, under the law of any of the Channel Islands, the Isle of Man or any of the British Overseas Territories (see below).[10]

The present list of British Overseas Territories is as follows: Anguilla, Bermuda, British Antarctic Territory, British Indian Ocean Territory, British Virgin Islands, Cayman Islands, Falkland Islands, Gibraltar, Montserrat, Pitcairn, Henderson, Ducie and Oeno Islands, St Helena, Ascension and Tristan da Cunha, South Georgia and the South Sandwich Islands, the Sovereign Base Areas of Akrotiri and Dhekelia in Cyprus, and the Turks and Caicos Islands.[11]

Note that the general provisions regarding extra-territorial application expressly provide that they do not limit the (in some respects) wider provisions that may be made in the context of shipping sanctions – (see below).[12] Before turning to the shipping sanctions, it is worth considering the issues of jurisdictional overlap.

The jurisdictional overlap between the EU and UK regimes post Brexit

It can be seen at a glance from the above that there may be an overlap between the jurisdictional scope of the UK and EU regimes.

The EU sanctions regimes generally apply within the territory of the EU; on-board any ship or aircraft under the jurisdiction of a Member State (i.e. flagged in a Member State or physically present in a Member State); to any national of any Member State, whether they are within the EU or not; to any legal person, entity or body incorporated under the laws of any Member State, whether inside or outside the territory of the EU; *and to any legal person, entity or body in respect of any business done in the EU.*

Accordingly, following the end of the transition period, an EU person conducting business in the UK will be subject to the EU regime and the UK regime (it will be a legal person incorporated under the laws of a Member State conducting business in the UK). Likewise, a UK person conducting business in the EU will be subject to both

[9] S.63 SAMLA 2018
[10] S. 21 SAMLA 2018
[11] British Overseas Territories Act 2002
[12] S.21(6) SAMLA

regimes (it will be a United Kingdom person (and so subject to the UK regime) conducting business in the EU (and so subject to the EU regime)).

Where there is a jurisdictional overlap between the EU and UK regimes, it will be necessary to comply with both regimes and compliance will be more complicated where the regimes differ.

The UK has stated its policy is to remain aligned with EU sanctions. However, even leaving aside the issue of whether a divergence in policy arises over time, for example because of greater alignment with the US in certain areas or because of taking an autonomous position aligned with neither the EU nor the US, there will inevitably be technical differences.

To give a couple of much quoted examples:

- Article 5 of Council Regulation (EU) No 833/2014 (the "EU Russia Regulation") which imposes the Russian sectoral sanctions broadly restricts the provision of investment services and credit to certain listed entities. The restrictions also apply to their 50% plus subsidiaries established outside the EU. The "equivalent" provisions under (the UK's) The Russia (Sanctions) (EU Exit) Regulations 2019 (The "UK Russia Regulations") (which are yet to come into force) apply to the same list of designated Russian entities and their 50% plus subsidiaries incorporated outside the UK.[13]

Accordingly, in the absence of any changes in the position between now and the end of the transition period, a financing by a UK bank to an EU subsidiary of a designated Russian entity and a financing by an EU bank to a UK subsidiary of a designated Russian entity, which are both currently permitted, will cease to be permitted.

- The EU Russia Regulation includes a number of restrictions on providing financing or financial assistance in connection with the supply of designated goods to persons in Russia. The UK, unlike some other EU Member States, has taken a broad view of the meaning of financial assistance as covering the

[13] Regulation 16, The Russia (Sanctions) (EU Exit) Regulations 2019, SI 2020 No. 590

processing of payments. In *PSCJ Rosneft Oil Company v Her Majesty's Treasury*, the ECJU held that "financial assistance" did not include the processing of a payment.

The UK Russia Regulation uses the term "financial services". This is not defined in the UK Russia Regulations, but the related OFSI Guidance makes it clear that this includes processing payments - "where the provision of financial services is prohibited, this includes the provision of processing payments".[14] This may appear a narrow technical distinction, but it is one that could have significance; it may make the difference between whether acting solely as the processing bank on a relevant transaction is permitted or requires authorisation.

Where there are differences, these will be likely to increase the compliance burden. If and where there are direct conflicts, this can give rise to much more difficult and complex issues – see further below under "The EU Blocking Regulation and other Anti-Boycott Measures".

[14] Russia Guidance: Guidance for the financial and investment restrictions in Russia (Sanctions) (EU Exit) Regulations 2019, June 2020. "Financial services" are also defined in S.61 SAMLA to include "payment and money transmission services".

SHIPPING SANCTIONS

As noted above, sanctions compliance by entities involved in the shipping sector is essential to the effectiveness of many sanctions regimes and shipping is, by its nature, an activity which may be particularly susceptible to sanctions violation. It is therefore perhaps not surprising that SAMLA includes extensive provisions empowering the imposition of sanctions affecting shipping and the powers granted are very wide.

Powers are given to make regulations for each of the following purposes:

- To control the movement of disqualified, designated or specified ships to prevent them from entering UK territorial waters or, if they have done so, to detain or control their movement within UK territorial waters or to require them to leave UK territorial waters.[15]

A disqualified ship is one which is owned, controlled, chartered, operated or crewed by designated persons, persons connected with a prescribed country or by a prescribed description of persons connected with a prescribed country or a ship which is registered in, flies the flag of, or originates from, a prescribed country.[16]

A designated ship is one which has been designated by the UN.[17]

A specified ship is one specified pursuant to the powers given by S.14 SAMLA. These authorise an appropriate Minister to specify a ship where it has reasonable grounds to suspect that the ship is, has been, or *is likely to be*, involved in activity specified in the regulations (i.e. shipping sanctions or trade sanctions):[18]

- To prevent persons from owning, controlling, chartering or operating ships registered in, or flying the flag of, a prescribed country or specified ships.[19]
- To prevent the registration on the UK Ship Register of ships in which a designated person or a person connected with a prescribed country holds a prescribed interest and of specified ships.[20] and
- For the Secretary of State to give orders to the master or pilot of a British ship anywhere in the world to prevent it from travelling to the territorial seas adjacent to a prescribed country or a particular place in those seas or harbours in a prescribed country.

A British ship includes a ship registered under the Merchant Shipping Act 1995 or registered under the law of a relevant British possession. A relevant British possession means any of the Channel Islands, the Isle of Man and any British Overseas Territory (see above for current list).[21]

[15] S.7 (1) (a) and (b) SAMLA
[16] S. 7(8) SAMLA.
[17] S.7(6) SAMLA
[18] Ss. 7(1)(a) (ii), 14 (1) and (6) SAMLA
[19] S.7 1(c) SAMLA
[20] SS.7 (1)(e) and 7(14)
[21] SS. 7(5), 7(12) and 7(14)

STOP, SEARCH, SEIZE AND DETAIN – EXTRA-TERRITORIAL POWERS

SAMLA grants very wide enforcement powers in relation to:

- British ships in foreign waters or international waters;
- Ships without nationality in international waters; and
- Foreign ships in international waters.

It gives power to stop a ship, board a ship, search a ship, seize goods found on a ship and require the ship to be taken to and remain in UK territorial waters or any other country willing to receive it.

These powers have potentially wide extra-territorial application. They may be exercised for the purposes of enforcing prohibitions in sanctions regulations relating to the import, export or movement of prescribed goods or the transfer or acquisition of prescribed technology by persons subject to the sanctions. They may also be exercised for the purpose of investigating the suspected carriage or preventing the continued carriage of relevant goods *outside the United Kingdom by a person other than a United Kingdom person where that activity would constitute a contravention of a SAMLA sanction if it had been in the United Kingdom or by a United Kingdom person.*[22]

A number of these powers have been incorporated into the sanctions regimes to be implemented pursuant to SAMLA; see for example Part 10 of the UK Russia Regulation.[23]

[22] Ss.19 and 20 and Schedule 1 SAMLA

[23] These powers are subject to certain limitations in relation to a British ship in foreign waters and foreign ships. The powers are similar to those in Part 4, Chapter 5 of the Policing and Crime Act 2017, which are exercisable where there are reasonable grounds to suspect that a criminal offence has been or is being committed.

US ADVISORY AND OFSI MARITIME GUIDANCE

The US Advisory has been described as a guidepost to help participants in the maritime sector achieve the desired level of compliance. Most of the guidance is couched in the language of suggestion (e.g., parties "may wish to consider…"), rather than as a mandate. However, it is clear that the US government wishes parties to follow the guidance in the US Advisory as closely as possible.

While the maritime sector has always been a focal point of trade sanctions, since 2018, the Trump Administration has increasingly focused on the maritime sector in policing its "maximum pressure" campaign to enforce US sanctions. US "secondary" or "extra-territorial" sanctions largely prohibit non-US parties from dealing with North Korea, Iran and other sanctioned parties. These sanctions often target the maritime sectors of the relevant countries, as well as shipments of oil, natural gas and various commodities.

In order for these sanctions to be effective in putting pressure on the target countries, the US government needs the global maritime community to police itself, and for players to ensure that both they and their counterparts are in compliance. In a sense, this is similar to the push in the early 2010s to force international financial institutions to implement US sanctions worldwide. However, unlike banks, which are heavily regulated and have substantial compliance obligations outside of sanctions, many players in the maritime sector are small and do not have a sophisticated compliance infrastructure, which may make it more difficult to comply.

The following are some of the more salient points in the US Advisory:

AIS transponders

Ships use Automatic Identification System (AIS) transponders to transmit their location. In most cases, they remain active at all times, so the ship's progress can be tracked. However, transponders may fail due to weather conditions or other technical problems and may be turned off for legitimate reasons (e.g. in a location where piracy is a concern). OFAC is concerned that ships may turn off or disguise their transponders in order to engage in surreptitious trade in violation of sanctions. This follows news reports and allegations that various ships turned off their transponders when secretly transporting Iranian crude oil to East Asia.

The US Advisory suggests that parties should research a ship's history to identify previous AIS manipulation before entering into new contracts involving the ship, and monitor AIS manipulation and disablement when cargo is in transit. The US Advisory also suggests that relevant contracts include a clause requiring the AIS to broadcast at all times, and permitting termination where the clause is breached – see further on this below.

Ship-to-Ship (STS) transfers

OFAC is concerned that STS transfers can be used to evade sanctions by disguising the origin or destination of the relevant cargo. While OFAC acknowledges that STS transfers can be conducted for legitimate purposes, OFAC flags such transfers as potential sanctions evasion, especially if conducted "at night or in areas determined to be high risk for sanctions evasion or other illicit activity." The US Advisory includes a map showing areas near the Korea Peninsula, China and Eastern Russia that are thought to be high risk for North Korean sanctions evasion. No similar map is shown for other areas (e.g., the Persian Gulf or offshore Syria).

"Name-and-Shame" lists

Previous sanctions advisories have included a list of ships and shipowners identified as having traded with Syria, Iran and North Korea, and having engaged in STS transfers of cargo that ended up in these countries. The previous advisories made clear that they were not "sanctions lists" (i.e. that the parties listed were not blocked and generally could be dealt with), and that there was no determination that a sanctions violation had occurred. Nevertheless, the market largely reacted to these "name-and-shame" lists as if they were sanctions lists.

The US Advisory does not revise the "name-and-shame" lists, neither to add new parties to the lists, nor to "remove" existing parties (although given that the lists are not official, it is not clear what the removal of a name would entail). The US Advisory merely says that there may be further "updates" in the future, but gives no hint as to what such an update would involve.

Maritime sector participant checklists

The US Advisory includes an annex containing "checklist" guidelines for maritime sector participants to follow. The US Advisory does not require participants to follow all of the checklist guidelines, but adherence is clearly encouraged.

The annex includes checklists for the following parties:

- maritime insurance companies;
- flag registry managers;
- port state control authorities;
- shipping industry associations;
- regional and global commodity trading, supplier, and brokering companies;
- financial institutions;
- shipowners, operators, and charterers;
- classification societies;
- vessel captains; and
- crewing companies.

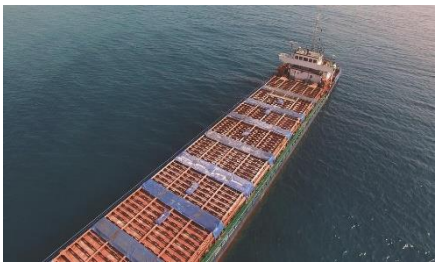
Sanctions programme annex

The US Advisory includes a second annex describing the relevant sanctions programmes targeting North Korea, Iran and Syria, and including country-specific guidance. The inclusion of North Korea and Iran is consistent with the highly comprehensive US "secondary sanctions" targeting both countries, as well as UN sanctions against North Korea. Syria's inclusion is consistent with previous advisories, and significant secondary sanctions targeting Syria have recently been implemented. Also of interest is the absence of a separate listing for Venezuela, which has been the target of a significant escalation of US sanctions over the past year and has been the focus of a crackdown on sanctions evasion.

OFSI Maritime Guidance

OFSI's Maritime Guidance is different in tone to the US Sanctions Advisory and, save as mentioned below, is not prescriptive but generally focused on raising awareness: awareness of the purpose of sanctions, awareness of their main forms and awareness of how would be sanctions evaders can use shipping to contravene sanctions by a variety of illicit practices. The one area in which the tone appears to be more than educational is in respect of due diligence – see below.

OFSI, which to date has largely concentrated on financial services, has turned its focus on shipping no doubt partly for the reasons set out above – while compliance



by shipping is essential to the effectiveness of sanctions, shipping is vulnerable to evaders. However, it also has additional reasons to do so. OFSI is the authority for the implementation of financial sanctions in the UK and, as it notes "The UK is renowned across the globe for its leadership in the maritime shipping industry. …The UK...operates the largest share of global maritime insurance, with around a third of the total market. This is more than the United States, Japan, Germany and France. 13 of the major international P&I Clubs, who insure around 90% of the world merchant tonnage, operate from management offices in the UK*".*

Guidance and illicit practices

The Guidance provides a reminder that financial sanctions impose restrictions on funds and economic resources that are owned, held, controlled or made available to or for the benefit of designated persons or entities. It further notes that while a number of vessels and companies appear on the consolidated list, a vessel or company not on the list but which is owned or controlled by designated persons is also captured and the subject of financial sanctions.

The Guidance goes on to provide a non-exhaustive list of a variety of tactics deployed to confuse or conceal the identities of vessels, cargo, routes and ports, described as illicit and suspicious shipping practices. Unsurprisingly, there is some overlap with the practices highlighted by the US Advisory. The non-exhaustive list includes:

- Ship-to-ship transfers, where used to conceal the origin, nature or destination of cargo;
- Disabling of AIS to obfuscate a vessel's whereabouts and not for legitimate purposes;
- Cyber activity (attacks) to illegally force the transfer of funds and cryptocurrency exchanges to circumvent financial sanctions;
- Financial system abuse – bank accounts being set up with the primary purpose of engaging in and concealing illicit activities;
- False documentation – the falsification of documentation to seek to obscure the origin of a vessel, its goods, its destination and the legitimacy of the vessel; and
- Concealment – physically concealing illicit cargo on board a vessel.

The Guidance notes that not all the practices described above are necessarily in themselves breaches of financial sanctions regulations in all cases but suggests that they should at least raise suspicions.

The Guidance highlights some aspects of some of the EU regimes (those in respect of the Democratic People's Republic of Korea, Iran, Libya, Syria), no doubt because these are considered to be particularly relevant to shipping activities. However, there are of course others which are equally relevant, such as the EU Regulation relating to Crimea and Sevastopol.[24]

Perhaps the key aspect of the Guidance to note are the comments on what is expected in terms of due diligence. The Guidance provides:

"Each organisation should assess its own risks and put due diligence measures in place to manage these risks. OFSI does not mandate specific measures to be taken.

[24] Council Regulation (EU) No 629/2014

OFSI can provide guidance as to what measures may be helpful…but the onus is on the organisation to ensure it does not breach financial sanctions".

It then sets out general guidance regarding due diligence measures which organisations operating in the maritime sector may wish to consider. These include:

- Companies conducting activity in or around high-risk jurisdictions should seek to have a robust understanding of the sanctions in place, seek independent legal advice and operate a risk-based approach conducting enhanced due diligence to understand the full range of activity and the persons involved in supply chains etc;
- The use of AIS screening and AIS "switch off" clauses in contracts. As noted above, OFSI acknowledge that AIS switch off does not necessarily confirm illicit activity and they suggest that due diligence could be enhanced by contacting vessels that have "gone dark" to better understand the causes and review trends;
- Systems for checking on ownership structures, vessel flag information, details of home ports and recently visited ports; and
- Checking suspicious letters of credit, bills of lading, cargo lists and insurance documents.

US PRIMARY SANCTIONS, SECONDARY SANCTIONS AND THEIR EXTRA-TERRITORIAL EFFECT

US sanctions overview

Traditional US sanctions (sometimes referred to as "primary sanctions") apply by "blocking" or "freezing" the assets of a "specially designated national" ("SDN"). This means that the SDN's assets in the US are frozen, and cannot be retrieved without permission from OFAC, and that US persons generally are not permitted to transact with SDNs.

US person/facilitation

Traditionally, US sanctions applied only to "US persons," which generally means a US citizen or permanent resident, an entity organised in the US (including foreign branches) and anyone in the US (which generally includes US branches of foreign entities, as well as any individuals who are physically in the US). Some but not all sanctions programmes also apply to non-US subsidiaries of US persons.

Although the sanctions appear limited in scope, they apply quite broadly due to "facilitation". The facilitation rule generally means that a US person cannot "facilitate" a transaction by a non-US person that would be prohibited by sanctions if conducted by the US person. In addition, a non-US person that "causes" a US person to commit facilitation can be liable. This rule is most relevant for the use of US dollars. Because almost all wire transfers in US dollars are cleared through US banks, a US dollar payment to or from a sanctioned person or country constitutes "facilitation".

Secondary sanctions

Unlike primary sanctions, secondary sanctions target non-US persons. The precise scope and application of secondary sanctions depend on the programme, but in general, they target significant transactions with targeted individuals or entities, or in relation to targeted sectors of the targeted country's economy. For example, Iran secondary sanctions generally apply to a non-US person that engages in significant transactions with Iran's oil and gas sector, or with Iranian SDNs. A non-US person operating in Iran that does not engage in transactions with prohibited sectors or SDNs generally will not be in violation of secondary sanctions.

Unlike primary sanctions, which generally are enforced by the issuance of monetary fines and penalties, secondary sanctions generally apply by threatening non-US persons with various levels of exclusion from the US and US markets (e.g. inability to import US goods) if they engage in the specified targeted practices. In practice, the primary risk for non-US persons is being added to the SDN list.

Although secondary sanctions have existed for decades, they had a minor impact until 2010, when secondary sanctions against Iran were strengthened. The Trump Administration has dramatically expanded the use of secondary sanctions, re-imposing and adding to sanctions on Iran (which had been lifted in 2016 by the Joint Comprehensive Plan of Action (JCPOA)), and targeting North Korea, Russia, Venezuela and Syria, terrorism and, most recently, Hong Kong with secondary sanctions.

THE EU BLOCKING REGULATION AND OTHER ANTI-BOYCOTT MEASURES

The general response to the extra-territorial reach of US sanctions, certainly by international financial institutions, is not only to comply with them but also to require of their borrowers and their borrowers' charterers a standard of observance that will not put them in breach.

However, it is not always that simple. Some jurisdictions have implemented legislation to protect against the effects of the extra-territorial application of other countries' sanctions, which in effect means prohibiting compliance with the relevant other country's measures.

The most well known of these is the EU Blocking Regulation.[25] It was originally adopted in 1996 for the purpose of protecting against and counteracting the effects of the extra-territorial application of laws specified in the annex to the Regulation. The relevant laws were US measures against Cuba, Libya and Iran, which were perceived to negatively affect the ability of EU entities to engage in trade with these countries which was permitted under EU law.

In response to the US's withdrawal from the JCPOA in 2018 and its re-imposition of certain sanctions against Iran that had previously been lifted under the JCPOA, the EU in effect re-activated and expanded the scope of the EU Blocking Regulation to cover the re-imposed US measures against Iran.

The EU Blocking Regulation has direct effect in the UK and will, it is contemplated, continue to have effect as retained law after the end of the transition period.[26] Furthermore, the UK government has stated "*We intend to uphold the policy intent of the Blocking Regulation in our statute book once we have left the EU, so that we can mitigate the impact of extra-territorial sanctions on our trading interests. The UK will assume responsibility for listing extra-territorial sanctions legislation with which UK businesses must not comply*".[27] Accordingly, it might be expected that the UK's future blocking legislation might differ from and be wider than the EU's.

In the current context, the most relevant provision of the EU Blocking Regulation is Article 5 which provides that the persons to which it applies (see below) shall not:

"*comply, whether directly or through a subsidiary or other intermediary person, actively or by deliberate omission, with any requirement or prohibition, including requests of foreign courts, based on or resulting, directly or indirectly, from the laws specified in the Annex or from actions based thereon or resulting therefrom*".

The EU Blocking Regulation applies to:

- Natural persons who are nationals of an EU Member State and resident in the EU;
- Legal persons incorporated in the EU;
- Natural or legal persons established outside the EU but controlled by nationals of EU Member States, and shipping companies established outside the EU where

[25] Regulation (EC) No 2271/96 as amended by Commission Delegated Regulation (EU) 2018/1100. There are others, notably the "German Blocking Provisions" - section 7 of the German Foreign Trade Regulation (Außenwirtschaftsverordnung, AWV) (in connection with section 4 paragraph 1 and section 19 paragraph 3 no. 1a German Foreign Trade Act (Außenwirtschaftsgesetz, AWG)).
[26] Protecting against the Effects of the Extra-territorial Application of Third Country Legislation (Amendment) (EU Exit) Regulations 2019 (Draft).
[27] Explanatory Memorandum to The Extra-territorial US Legislation (Sanctions Against Cuba, Iran And Libya) (Protection of Trading Interests) (Amendment) Order 2018, 2018/1357

they are controlled by EU nationals and where the vessels are flagged in the same EU Member State;
- Other natural persons resident in the EU unless that person is in the country of which he is a national; and
- Any other natural person within the EU, including its territorial waters and air space, and in any aircraft or on any vessel under the jurisdiction or control of a Member State, and acting in a professional capacity.

Compliance with US secondary sanctions?

There are numerous difficulties in the interpretation of the EU Blocking Regulation.[28] One such issue, given that at the heart of the EU Blocking Regulation is a prohibition on "complying" with the relevant foreign laws, is whether it makes sense to speak of complying with US secondary sanctions on the basis that they do not set out specific prohibitions or requirements but rather provide for adverse consequences to follow sanctionable activity by a non-US Person.

This point seems to have been answered for now in the affirmative (from a UK perspective) by the recent Court of Appeal decision in *Lamesa Investments Limited v Cynergy Bank Limited*.[29] This was not a case relating to any of the legislation referred to in the Annex to the EU Blocking Regulation, but rather a case relating to the (US) Ukraine Freedom Support Act 2014 in which the defendant claimed that it had not made a payment otherwise due under a loan to it in order to comply with the US legislation. Nonetheless, the "compliance" issue was addressed, and the Court held "the important point is that [the language of the Blocking Regulation] refers to the provisions of US secondary sanctions legislation…as imposing a "requirement or prohibition" on EU entities. That is the reality of the position. An EU entity cannot ignore such legislation, because if it does so, its business will be disrupted…Once the US legislation is seen, as it must be, as an effective prohibition, [the defendant's] reason for non-payment is indeed to comply with it".

As noted, the US legislation at issue in the *Lamesa* case was not legislation covered by the EU Blocking Regulation. At an earlier hearing of the case in the High Court, the claimant had raised the argument that recognising Lamesa's need to comply with the US secondary sanctions in issue would be contrary to "… the UK's long-standing policy of not giving extra-territorial effect to US foreign policy as enacted through its secondary sanctions programmes." The High Court held that there was no such mandatory rule and that the only such rule that is incorporated into English law is that contained in the EU Blocking Regulation which applies only to those laws specified in the Appendix to it.

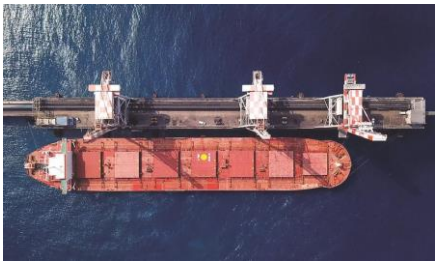
Based on the above, it is reasonable to conclude that:

- Where an English law contract requires a party to comply with US secondary sanctions (at least where the EU Blocking Regulation is not engaged), an English court will recognise the relevant US secondary sanctions as giving rise to requirements or prohibitions requiring compliance;
- Where the relevant US secondary sanctions are not those specified in the EU Blocking Regulation, the parties are free, through their contractual arrangements, to address compliance or not with the US secondary sanctions between them as they wish; and

[28] See The Financial Markets Law Committee's helpful paper "U.S. Sanctions and the E.U. Blocking Regulation: Issues of Legal Uncertainty" June 2019.
[29] [2020] EWCA Civ82. See our earlier briefing - here.

- Possibly, where the relevant US secondary sanctions are those specified in the EU Blocking Regulation, it is not possible, contractually to require compliance with them by a party which is bound by the EU Blocking Regulation.

CONCLUSIONS



- Compliance with sanctions will likely become more complicated following the end of the Brexit transition period. It will become necessary to carefully review the UK sanctions regime;
- The UK regime will have extra-territorial application;
- Following the end of the Brexit transition period, the EU and UK regimes will not be identical;
- There are circumstances in which both regimes may apply in which case compliance with both will be required;
- There may well be circumstances in which something which was previously permitted will no longer be permitted;
- The UK regime under SAMLA gives the UK wide powers to impose extensive sanctions on shipping;
- The focus by the US and UK authorities on shipping underlines the importance of seeking to ensure sanctions compliance and having appropriate compliance systems in place;
- US secondary sanctions have extra-territorial effect and remain relevant to those subject to the EU and UK regimes;
- The EU Blocking Regulation gives rise to a difficult dilemma; it may not be possible to comply with the relevant US secondary sanctions and EU law;
- The UK regime will carry over the effects of the EU Blocking Regulation and may add to or amend the list of foreign country legislation with which it is prohibited to comply, quite possibly creating further dilemmas; and
- The potential sanctions issues relating to any proposed transaction require careful analysis and the contractual provisions in relevant documentation should not be treated as boilerplate but should be tailored to reflect and manage the risks.

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