

The Perils of ignoring Global Economic Sanctions

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The effort against both the increasing threat of terrorism and the development and proliferation of weapons of mass destruction, has consistently involved the implementation and imposition of economic sanctions against offending nations. Following action by the United Nations Security Council, the European Union Commission and the United States Government against Iran in particular, Al Tamimi & Company has been receiving more and more queries in relation to the impact of the various economic sanctions upon commercial relations with Iran.

Recurrent questions include, but are not limited to, the following:

- As an entity located in the United Arab Emirates (UAE), can Company “X” deal with any Iranian entities?
- If an Iranian Company is subject to the UN/EU/US sanctions, can Company “X” still work with the Iranian Company as an UAE registered company? What economic and/or penal repercussions could this have on the Company or its staff, if any?
- Shall Company “X” conduct enhanced due diligence to determine if transactions contains a “Government of Iran” element or interest?
- In case an Iranian Company is subject to UN/EU/US sanctions, can/should Company “X” (easily) cut ties and halt business with the Iranian Company or does it face the possibility of being blacklisted or isolated from the global financial system?

It is crucial that a lawyer be aware of any transactions when his/her client or a client’s business partner is located in a sanctioned country, has business dealings with a sanctioned country, gained its funds from a sanctioned country or is owned or controlled by a sanctioned entity or individual. The reason why it is so crucial for such a determination to take place is that the number of economic sanctions continue to increase as do the potential consequences upon the client, whether at the business or at the personal level. One only has to witness the recent significant financial penalties upon major global banks as reported in official press releases (e.g. Standard Chartered Bank) and the potential penalties upon other financial institutions that have transgressed the economic sanctions against trade dealings with Iran.

In order to properly understand the significance of the global economic sanctions, one must understand their primary objectives and implications.

Given the complexity of this topic, this article is not an exhaustive analysis of all the existing economic sanctions and mainly addresses the Iran sanctions, in light of the UAE and Iran trade ties and geographical proximity. For more information on this article, please contact Ibtissem Lassoued, Senior Associate - Special Projects Department: i.lassoued@tamimi.com.

1. Global Economic Sanctions: Global Effective Measures for Global Concern

An economic sanction can be defined as “any action taken by one country or a group of countries acting collectively in order to harm the economy of another country or group of countries, with the objective being to engender economic or political change.” Often used as an instrument of foreign policy, it can be applied for various reasons including, but not limited to, the punishment of the other country, or as an incentive for change, political, policy or otherwise, in the target country. There are two general types of sanctions that are exercised: unilateral sanctions (imposed by a single country against another) or bilateral sanctions (sanctions imposed by a group of countries acting either individually or collectively against

another). Economic Sanctions can affect all industries and there are several ways in which a sanction is exercised through laws and regulations of imposing states including mainly the following:

- Trade restrictions (embargoes) that prevent a country and its citizens from engaging in economic activity with the sanctioned country.
- Blocking or freezing of assets and restrictions on movement of people or capital.
- Imposition of taxes on goods imported from the country against which the sanction is exercised.
- Restrictions placed on goods imported into a country from a country against which the sanction is exercised.
- Quotas on the quantity of goods that can be either exported or imported from country subject to sanctions.

a) Countries / International Entities Exercising Economic Sanctions

<i>Country / International Organization Exercising Economic Sanctions</i>	<i>In Practice</i>	<i>Examples of Middle East Countries Subject to Economic Sanctions</i>
<i>United Nations (UN) Security Council Sanction Committee</i>	<p>The UN imposes mandatory sanctions on countries through the Security Council Sanctions Committees (the "SC") under Articles 39 and 41 of Chapter VII of the UN Charter.</p> <p>The SC adopted: (i) Resolution 1730 (2006) by which the SC requested the Secretary-General to establish within the Secretariat, a focal point to receive de-listing requests and (ii) Resolution 1904 (2009) by which it established the Office of the Ombudsperson.</p>	<p>Iran</p> <ul style="list-style-type: none"> • Resolution No. 1696 of 2006 • Resolution No. 1737 of 2006 • Resolution No. 1747 of 2007 • Resolution No. 1803 of 2008 • Resolution No. 1835 of 2008 • Resolution No. 1929 of 2010 <p>Iraq</p> <ul style="list-style-type: none"> • Resolution No. 1518 of 2003 <p>Lebanon</p> <ul style="list-style-type: none"> • Resolution No. 1701 of 2006 <p>Libya</p> <ul style="list-style-type: none"> • Resolution No. 1970 of 2010
<i>European Union (EU)</i>	<p>The EU imposes sanctions and restrictive measures pursuant to the objectives of the EU Common Foreign and Security Policy (CFSP) as set out in Article 11 of the Treaty establishing the European Union.</p> <p>The Guidelines on Implementation and Evaluation of Restrictive Measures (Sanctions) in the Framework of the EU Common Foreign and Security Policy provides guidance and standard wording that could be used in legal instruments.</p>	<p>Iran</p> <ul style="list-style-type: none"> • Council Regulation (EU) No. 961/2010 <p>Iraq</p> <ul style="list-style-type: none"> • Council Regulation (EC) No. 1210/2003 <p>Lebanon</p> <ul style="list-style-type: none"> • Common Position 2006/625/CFSP <p>Syria</p> <ul style="list-style-type: none"> • Council Regulation (EU) No. 442/2011

<p><i>Country, individually</i></p>	<p>In the US: Sanctions are set forth in the Iranian Transactions Regulations (31 CFR Part 560)¹ and enforced through the Office of Foreign Assets Control (OFAC) which derives its authority from a variety of US federal laws regarding embargoes and economic sanctions and operates under the auspices of the US Department of the Treasury. OFAC administers and regularly updates the Specially Designated Nationals (SDN) List which is a publication listing individuals and organizations with whom US citizens and permanent residents are prohibited from doing business. OFAC regulations often provide general licenses authorizing the performance of certain categories of transactions and also issues specific licenses on a case-by-case basis under certain limited situations and conditions². Other countries: Countries other than the US also impose sanctions on individuals/entities/third countries and frame their stands on sanctions ensuring their national interests are protected.</p>	<p>Currently, OFAC administers sanctions programs against the following countries in the MENA Region (Middle East and North Africa) see notes below:</p> <ul style="list-style-type: none"> • Iran³ • Iraq • Lebanon • Libya • Syria⁴ • Yemen • Iran <p>Countries such as Switzerland, Canada⁵, Australia, the UK and Japan have recently tightened sanctions against Iran.</p>
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Notes:

- Iraq: After the fall of Saddam Hussein regime, there are still certain prohibitions and asset freezes against specific individuals and entities associated with the former regime.
- Libya: After the fall of Gaddafi regime, the United Nations, the European Union and the United States have progressively been removing restrictions on Libya with restrictions remaining for individuals and entities associated with the former regime.
- Yemen: No resolutions were passed by either the UN or the EU imposing sanctions on Yemen with recently only the US passing an Executive Order dated 16th May 2012 which provides the US Treasury Department with a new authority to target individuals and entities posing a threat to Yemen's peace, security, or stability. Upon identification and listing of a designated individual or entity under this Executive Order by OFAC, any property in the United States or in the possession or control of United States persons in which the individual or entity has an interest would be blocked, and United States persons would be prohibited from engaging in transactions with them.

b) Comprehensive Sanctions Imposed Against Iran to Curtail Nuclear Armament Development

I. Scope of the Sanctions:

The sanctions cover mainly (a) the blocking of persons involved in terrorism, proliferation of mass destruction weapon and (b) Iran's energy sector and financial transactions with Iran.

• US Key Sanctions⁶

- Executive Order 12170/November 1979, resulting in the freezing of about USD 12 billion in Iranian assets, including bank deposits, gold and other properties.
- Executive Orders 12205 and 12211/April 1980, prohibiting certain transactions with Iran.
- Executive Order 12276/January 1981, relating to establishment of Escrow accounts.
- Executive Order 12277/January 1981, relating to transfer Iranian Government assets.
- Executive Order 12278/January 1981, direction to transfer Iranian Government assets overseas.
- Executive Order 12279/January 1981, direction to transfer Iranian Government assets held by domestic banks.
- Executive Order 12280/January 1981, direction to transfer Iranian Government financial assets held by non-banking institutions.

- Executive Order 12281/January 1981, direction to transfer certain Iranian Government assets.
- Executive Order 12282/January 1981, revocation of prohibitions against transactions involving Iran.
- Executive Order 12283/January 1981, non-prosecution of claims of hostages and for actions at the United States Embassy and elsewhere.
- Executive Order 12284/January 1981, restrictions on the transfer of property of the former Shah of Iran.
- Executive Order 12294/February 1981, suspension of litigation against Iran.
- Executive Order 12613/October 1987, prohibiting the importation and exportation of any goods or services from Iran.
- Executive Order 12613/October 1987, prohibiting imports from Iran.
- Executive Order 12957/March 1995, prohibiting United States trade in Iran's oil industry.
- Executive Order 12959/May 1995, prohibiting United States trade in Iran's oil industry.
- Iran-Libya Sanctions Act 1996 further broadening the scope of US sanctions against Iran for companies engaging in energy transactions with Iran.
- Executive Order 13059/August 1997, prohibiting on exports and imports between the US and Iran or with Iran by a US person.
- Executive Order 13224/ September 2001 on terrorist financing, blocking property and prohibiting transactions with persons who commit, threaten to commit, or support terrorism.
- Executive Order 13382/June 2005, freezing the assets of individuals connected with Iran's nuclear program.
- Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (CISADA) / July 2010.

The CISADA authorized sanctions on foreign financial institutions that engage in financial transactions with:

- Financial institutions designated in Iran WMD and support to terrorism
- UN listed individuals and entities
- IRGC or its agents or its affiliates

Note: The financial provisions of CISADA are implemented through the Iranian Financial Sanctions Regulations (IFSR) issued by the US Treasury Department in August 2010.

- Executive Order 13553/September 2010, Executive Order 13574/May 2011 and Executive Order 13590/November 2011, strengthening existing U.S. sanctions with respect to the Iranian energy industry, and adds the potential for the imposition of serious limits on foreign financial institutions' access to the U.S. financial system if they engage in certain transactions involving Iran.

Recently in 2012:

- Executive Order 13599/February 2012, blocking all property of the Government of Iran and Iranian Financial Institutions subject to US jurisdiction.
- Executive Order 13606/April 2012, blocking all property and suspending entry into the US of certain persons with respect to Grave Human Rights Abuses by the Governments of Iran and Syria Via Information Technology (also referred to as the "Ghravity Executive Order")
- Executive Order 13608/May 2012, prohibiting certain transactions with and suspending entry into the US of Foreign Sanctions Evaders with respect to Iran and Syria (also referred to as the "Foreign Sanctions Evaders Executive Order").

• **UN Key Sanctions**

- Resolution Order 1696/July 2006, urging Iran to cease its nuclear enrichment and reprocessing activities, threatening the possibility of economic sanctions should it fail to do so.
- Resolution Order 1737/December 2006, Member States are requested to prevent Iran from importing and exporting "sensitive nuclear material and equipment".
- Resolution Order 1747/March 2007, banning Iranian arms exports, freezing assets and restricting travel of individuals engaged in the country's nuclear development activities.
- Resolution Order 1803/March 2008, apart from further extending the freezing of certain individuals'

assets, Member States were asked to inspect cargo to and from Iran of aircraft and vessels owned or operated by Iran Air Cargo and Islamic Republic of Iran Shipping Line should there be “reasonable grounds” to believe that prohibited goods were being transported.

- Resolution Order 1835/September 2008, affirming the previous four resolutions regarding trade restrictions, asset freezing, restriction of arms sales and movement of certain individuals coming from Iran due to the country’s continued non-compliance with the aforementioned resolutions.
- Resolution Order 1929/June 2010, noted the particular need to exercise vigilance over transactions involving Iran’s banks and the potential connection between Iran’s energy industry and the funding of its nuclear effort.

• **EU Key Sanctions**

- EU Council Regulation No. 961 /2010, relates to restrictive measures against Iran and repealed EU Council Regulation No 423/2007.
- 23 January 2012, EU foreign ministers agreed on Iran oil embargo i.e. to ban new contracts to import petroleum and petroleum products from Iran and to end existing contracts by 1st July, 2012. It is relevant to note that the OPEC proven crude oil reserves by end of 2010 were amounting to 151.17 billion barrels for Iran⁷, i.e. one of the highest proved oil reserves.
- 23 March 2012, EU Regulation No. 267 of 2012 replaced the earlier EU Regulation No. 961 of 2010 laying down the restrictions imposed on Iran by the EU.
- 20 May 2012, the G8 countries applied further pressure on Iran with a joint agreement to source oil from their strategic reserves if the situation with Iran worsened and there was a disruption to the supply of oil.

Sanctionable Activities and Restrictions:

- US Sanctions

As described in the IFSR, the sanctionable activities of a foreign financial institution are:

- Facilitating the efforts of the Government of Iran (GOI) to acquire or develop Weapons of Mass Destruction (WMD) or delivery systems for WMD or to provide support for terrorist organizations or acts of international terrorism;
 - Facilitating the activities of a person subject to financial sanctions pursuant to United Nations Security Council Resolutions 1737, 1747, 1803, or 1929, or any other Security Council resolution that imposes sanctions with respect to Iran;
 - Engaging in money laundering, or facilitating efforts by the Central Bank of Iran or any other Iranian financial institution, to carry out either of the facilitating activities described above; or
 - Facilitating a significant transaction or transactions or providing significant financial services for the IRGC or any of its agents or affiliates whose property and interests in property are blocked pursuant to the International Emergency Economic Powers Act (IEEPA), or a financial institution whose property and interests in property are blocked pursuant to IEEPA in connection with Iran’s proliferation of WMD, Iran’s proliferation of delivery systems for WMD, or Iran’s support for international terrorism.
- EU Sanctions

EU Council Regulation No 961/2010 implements additional restrictive measures against Iran, and repeals Regulation No 423/2007. It follows the UN Security Council Resolution 1929.

The restrictions are mainly as follows:

- Freezing of funds and economic resources of specific Iranian persons and entities;
- Restrictions on transfers of funds to and from an Iranian person, entity or body;
- Restrictions on Iran’s access to the EU’s bonds markets; and,
- Restrictions on Iran’s access to the EU’s insurance and reinsurance markets.

II. Consequences of breach

US sanctions:

The extra-jurisdictional approach by the US involves the unilateral imposition of an obligation on foreign entities to comply with its laws. Penalties vary from “caution” letters to transaction-based civil penalties, to criminal prosecution that could result in millions of dollars worth of fines or up to 20 years imprisonment (sentences vary based on the program). The penalty will be less important if there was a voluntary self-disclosure (e.g. a bank disclosing that through negligent or reckless conduct, it had breached the sanctions), than an egregious and willful breach of sanctions.

EU sanctions:

Each member country will enact its own statutes to give effect to EU criminal stipulations. Violations of EU legislation shall be punished either by fine or imprisonment. If the Member State is at fault, they will be required to pay the EU Commission a fine. For example, in the UK, the current maximum penalties for breaching the embargo on financing or importing crude oil or petroleum originating from Iran are imprisonment (for up to three months for summary offences and two years upon indictment) and/or a monetary fine (up to £5,000 on summary conviction and unlimited in the event of indictment).

UN sanctions:

To enforce sanctions, the UN requests that countries implement Resolution measures and establish authorized persons to ensure adherence to these sanctions within their respective territories. Since the UN is effectively a forum wherein other countries convene, it is assumed that a vote by members of the Security Council – or in wider sittings of the UN – could be used to impose sanctions on Member States who have violated the Iranian embargos.

2. Recent developments and the practical implications of Global Economic Sanctions

Disconnection of all Iranian banks from the international network Society for Worldwide Interbank Financial Telecommunication (SWIFT)⁸

On 17 March 2012, SWIFT – the worldwide financial messaging network to facilitate the interbank transfer of funds – disconnected all Iranian banks from its international network that had been identified as institutions in breach of current EU sanctions. This has been described as having the analogous effect of prohibiting access to waterways. This occurred following an agreement between all 27 Member States of the EU Council, and the Council’s subsequent ruling.

It is worth noting that SWIFT has never before expelled an institution in its 39 year history. There is a clear and present possibility that countries found to be non-compliant with EU, US and UN measures against Iran, could be compelled to ‘fall in line’ and become more cooperative with the sanctions via payment network sanctions.

There is a reasonable likelihood that Iran will successfully establish and implement its own SWIFT-type transfer systems so as not to get locked out of the international monetary system in the future. Cutting the network to Iran could force alternate networks to appear, similar to the “Barter Network”, as there is no other alternative currency to use. It is actually worth noting that on 26 May 2012, the Governor of the Central Bank of Iran Mr. Mahmoud Bahmani announced⁹ that it had created such a system. This proves that there may be indeed state-initiated avenues through which the various sanctions imposed on Iran can be made less effective if there are subscribers to these types of methods.

The Financial Action Task Force (FATF)

In June 2012, the FATF, which is an inter-governmental body to promote policies to combat money laundering and terrorist financing, reaffirmed¹⁰ its call on members and urged “all jurisdictions to advise

their financial institutions to give special attention to business relationships and transactions with Iran, including Iranian companies and financial institutions” and “to protect against correspondent relationships being used to bypass or evade counter-measures and risk mitigation practices and to take into account ML/FT risks when considering requests by Iranian financial institutions to open branches and subsidiaries in their jurisdiction”. Simultaneously, the FATF urged Iran to immediately address its AML/CFT deficiencies, in particular by criminalizing terrorist financing and implementing suspicious transaction reporting (STR) requirements, failing which the FATF will ask its members to strengthen counter-measures in October 2012.

Major Global Banks under investigation

Major Global Banks are currently being investigated by US regulators over allegations of illicit dollar transactions / money laundering with Iran, exposing non-US banks to sanctions by the US after the “u-turn exemption” was rendered illegal by the US Treasury in November 2008. In particular, said investigations are based on the use of the “wire stripping” technique by which global banks managed to ensure the anonymity of Iranian US Dollar clearing activities by stripping information from the SWIFT system and hence (i) removing references to Iranian entities and (ii) consequently not triggering investigations before clearing the US Dollar transactions via the bank’s branches located in the US (since sanctioned countries, individuals or entities’ names would not appear and hence could not be identified).

Examples of major global banks under official or internal investigation, as highlighted in various press releases and newspapers articles:

- Standard Chartered Bank (SCB): Benjamin Lawsky, superintendent of New York’s Department of Financial Services announced on 14 August 2012¹¹ that an agreement has been reached with the UK bank SCB. SCB shall pay a civil penalty of USD 340 million but also install an on-site monitor to ensure that SCB’s New York operations comply with the AML and book keeping requirements. In light of the aforementioned, SCB’s New York banking license has not been revoked, but SCB may have to contend with the other relevant US authorities with which it continues to engage.
- Other major global banks such as HSBC, Deutsche Bank, UniCredit¹², Royal Bank of Scotland (RBS)¹³ are currently under investigation by the Financial Services Authority, OFAC and the US Department of Justice for allegations of money laundering or allegedly breaching US sanctions.
- French banks BNP Paribas and Credit Agricole are currently conducting internal investigations into US dollar payments while Societe Generale stated it had returned its banking license to Tehran¹⁴.

US Foreign subsidiaries: Iran Sanctions Accountability and Human Rights Act of 2012

Since May 2012, there are no more loopholes in relation to the liability of US Parent Companies for Violations of Sanctions by Foreign Subsidiaries: in Section 218 of the Iran Sanctions Accountability and Human Rights Act of 2012, US Parent companies are held liable for dealings with Iran by their foreign subsidiaries, which means there will be no more exemptions for the latter even when non US persons would have facilitated the subsidiaries activities with Iran. Section 218 states the following: “Not later than 60 days after the date of the enactment of this Act, the President shall prohibit an entity owned or controlled by a United States person and established or maintained outside the United States from knowingly engaging in any transaction directly or indirectly with the Government of Iran or any person subject to the jurisdiction of the Government of Iran that would be prohibited by an order or regulation issued pursuant to the International Emergency Economic Powers act (50 U.S.C. 1701 et seq.) if the transaction were engaged in by a United States person or in the United States.”

In circumstances where US companies have subsidiaries located abroad and dealing with Iran, the US Parent companies would need to separate from those subsidiaries to avoid any liability.

3. The Ultimate Defense: Preventive Action

In light of the above, it appears that international companies need to be compliant with several

jurisdictions at the same time and the ultimate defense in protecting yourself from the possibility of infringing any of the highlighted sanctions is preventive action. Abstaining from dealing with blacklisted entities, ensuring that self-regulation is diligent and thorough, and actively ensuring the validity of client or transaction in line with applicable trade sanction laws will best enable a lawyer's client to comply with these far-reaching economic sanctions. Keeping abreast of legislative changes from the UN, EU and US that affect Iran and other sanctioned countries will allow for more time to effect the changes necessary to align your client's operations with the law.

Footnotes:

1. Amended in February 2012 to be updated in light of Section 1245 of the "National Defense Authorization Act for Fiscal Year 2012"
2. <http://www.treasury.gov/resource-center/sanctions/Pages/default.aspx>
3. <http://www.treasury.gov/resource-center/sanctions/Programs/pages/iran.aspx>
4. <http://www.treasury.gov/resource-center/sanctions/Programs/Pages/syria.aspx>
5. Example for Canada: <http://www.international.gc.ca/sanctions/iran.aspx?view=d>
6. Executive Orders rely on the International Emergency Economic Powers Act (IEEPA/1977)
7. http://www.opec.org/opec_web/en/data_graphs/330.htm
8. http://www.swift.com/news/press_releases/SWIFT_disconnect_Iranian_banks
9. <http://presstv.com/detail/2012/05/26/243243/iran-designs-alternative-swift-cbi/#.UD9sHCl43CM>
10. FATF Public Statement - 22 June 2012:
<http://www.fatf-gafi.org/topics/high-riskandnon-cooperativejurisdictions/documents/fatfpublicstatement-22june2012.html#Iran>
11. <http://www.dfs.ny.gov/about/press/pr1208141.htm>
12. <http://www.bbc.co.uk/news/business-19384702>
13. <http://www.bloomberg.com/news/2012-08-22/rbs-said-to-be-probed-by-u-s-regulators-over-iranian-sanctions.html>
14. French banks investigate potential breach of U.S. sanctions:
<http://www.reuters.com/article/2012/08/27/us-bnpparibas-creditagricole-sanctions-idUSBRE87Q0QN20120827?type=companyNews>