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Developments in US and EU Sanctions Compliance

On 20 January 2014, a six month partial suspension of US and EU sanctions in relation to Iran came into effect. In this briefing, we summarise the key issues, as well as other developments of interest affecting US and EU sanctions compliance in recent months.

Partial suspension of Iranian Sanctions

On 20 January 2014, the US and the EU suspended, for a period of 6 months, certain sanctions in relation to Iran in exchange for actions by Iran to curb its nuclear proliferation activities. The limited suspension of sanctions is part of the interim agreement that Iran reached with the E3/EU+3 countries (China, France, Germany, the Russian Federation, the UK and the USA) on a 'joint action plan' in November 2013.

While the long term objective of the joint action plan is to find a comprehensive solution to address concerns about the Iranian nuclear programme, which will see a lifting of all sanctions, it is important to note that the sanctions relief in the immediate term is limited, and will likely have only marginal impact on the compliance position of most US and EU financial and other organizations.

US measures

The US Treasury Department's Office of Foreign Assets Control ("OFAC") has issued guidance (in the form of a Guidance summary, Frequently Asked Questions or FAQs and a Statement of Licensing Policy) regarding the suspension of certain US extraterritorial sanctions for the 6 month period from 20 January to 20 July 2014.[1] The initial measures under the joint plan of action involve only a limited relief from certain sanctions and the vast majority of the US sanctions against Iran remain in place despite the 6 month temporary relief under the plan.

Specifically, the following US sanctions relief is effective under the US extraterritorial regime for the 6 month period:

- Suspension of extraterritorial sanctions on Iran's petrochemical exports and associated services – subject to limitations set forth in OFAC's FAQs # 4 and 5;
- Suspension of extraterritorial sanctions on Iran's automotive manufacturing sector and associated services – subject to limitations set forth in OFAC's FAQ # 7;
- Suspension of extraterritorial sanctions on Iran's import and export of gold and other precious metals, with limitations to prevent Iran from using its restricted assets overseas to pay for these purchases – subject to limitations set forth in OFAC's FAQ # 6;
- Suspension of efforts to further reduce Iran's crude oil exports to the six countries still purchasing from Iran (China, India, Turkey, Japan, South Korea and Taiwan) thereby allowing those countries to maintain their current average level of imports from Iran during the 6 month period – subject to limitations set forth in

In this briefing:

[1] OFAC's guidance is available at: http://www.treasury.gov/resource-center/sanctions/Programs/pages/iran.aspx.

OFAC's FAQ # 11; and

- Facilitation of a financial channel intended to support the sale of food, agricultural commodities, medicine and medical devices to Iran, as well as payments of medical expenses incurred abroad by Iranians, payments for Iran's UN obligations, and payments of Iran's agreed amount of governmental tuition assistance for Iranian students studying abroad. Non-US financial institutions whose participation in this channel is sought by Iran will be contacted directly by the US Government and provided specific guidance.

Under the above temporary and partial relaxation of US extraterritorial measures, any involvement of US persons or the US financial system would trigger a violation of OFAC's jurisdiction-based sanctions against Iran unless OFAC has licensed such involvement. In addition, unless the attached guidance expressly permits Specially Designated National ("SDN") involvement in regard to particular activity covered by the interim relief (as set forth in OFAC's guidance), SDN involvement could have the effect of exposing such activity to extraterritorial sanctions risk. More broadly, the temporary relief does not apply to activity which occurs before or after the 6-month window or involves other forms of sanctionable conduct apart from or in addition to the activity to which the relief applies.

OFAC's guidance indicates that non-US financial institutions may process non-USD payments in relation to activity that qualifies for the interim relief and/or provide other specified services without thereby engaging in sanctionable conduct, subject to the underlying activity complying with the restrictions imposed on eligibility for interim relief. Participating non-US financial institutions will incur a heavy diligence burden in this regard.

The only relief that will occur under the US jurisdiction-based sanctions (i.e., to activity involving US persons or US origin goods) involves the processing by OFAC of specific license applications for the supply of spare parts and services, including inspection services and repairs in Iran, for the safety of flight for Iran's civil aviation sector. OFAC provides additional information on this subject at FAQ # 10 and the Statement of Licensing Policy.

OFAC's guidance also confirms that the E3/EU+3 countries have committed to release certain restricted Iranian funds of up to USD 4.2 billion at regular intervals throughout the 6 month period, subject to certain conditions. OFAC intends to directly notify the banks that hold such funds when a release of the funds is authorized.

OFAC and the US State Department will continue to enforce those US sanctions against Iran that are not suspended. For example, on 12 December 2013, OFAC designated 4 individuals, 12 entities and 3 vessels as Specially Designated Nationals (SDNs) in response to their proscribed Iran-related activities.

EU measures

On 20 January 2014, the EU adopted Council Regulation 2014/42/EU[2], amending existing Council Regulation (EU) No. 267/2012 concerning restrictive measures against Iran. Pursuant to these changes, the majority of existing EU sanctions remain in place, including all measures targeted at designated entities, as well as restrictions on EU oil purchases from Iran and restrictions related to dual use items and other export controls.

The principal changes to current EU sanctions are as follows:

a) Suspension of the prohibition against EU persons insuring/reinsuring or transporting Iranian-origin crude oil to destinations outside the EU (the prohibition against purchasing or importing crude oil into the EU remains in place);

b) Suspension of the prohibitions against importing, purchasing or transporting Iranian origin petrochemical products, and the prohibition against providing related financial assistance;

c) Suspension of the prohibitions relating to trade in semi-manufactured gold, silver and other specified precious metals with the Iranian government;

In addition, while the current prohibition against transferring funds between EU financial institutions and their Iranian counterparts (as set out in article 30 of Regulation 267/2012) remains in place, the thresholds for obtaining prior authorisation for certain transfers that fall within the scope of existing exceptions have increased significantly.

[2] Available online at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2014:015:0018:0021:EN:PDF

Thus, transfers regarding personal remittances will now need only to be authorised in advance if over EUR 400,000 (previously EUR40,000), and transfers regarding foodstuffs, healthcare, medical equipment or for agricultural or humanitarian purposes need only be authorised in advance if over EUR1,000,000 (previously EUR100,000). It will still be necessary to notify all payments over EUR 10,000. For other transfers to and from Iranian persons entities or bodies (i.e. not payments between EU financial institutions and their Iranian counterparts), prior authorisation will now also only be required for transfers over EUR400,000 (previously EUR40,000). Again, any such transfers above EUR10,000 will still need to be notified in advance.

Definitions of 'ownership or control' and EU sanctions – confusion reigns

Planned Clarification in EU Guidelines

Since late December 2012, the Foreign Relations Counsellors Working Party (RELEX) of the Council of the European Union has been working to agree on a uniform interpretation of the prohibition on making funds or economic resources available indirectly to listed persons or entities, through persons or entities they either own or control. Once agreed, the relevant guidance is to be implemented into the Council's formal "*Guidelines on implementation and evaluation of restrictive measures (sanctions) in the framework of the EU Common Foreign and Security Policy*", a key document issued by the Council which gives practical guidance and recommendations on issues arising in the implementation of financial sanctions and the interpretation of EU sanctions Regulations.

See:
http://register.consilium.europa.eu/pdf/en/08/st08/st08666-re01.en08.pdf

A first set of guidance was adopted by the Council in February 2013, which made it clear that there is to be a presumption that the making available of funds or economic resources to non-listed persons or entities which are owned or controlled by a listed person or entity will in principle be considered as making them indirectly available to the listed person or entity. The presumption is rebuttable if it can reasonably be determined, on a case-by-case basis using a risk-based approach and taking into account all of the relevant circumstances, that the funds or economic resources concerned will not be used by or be for the benefit of that listed person or entity.

Among the factors to take into account are the contractual links between the entities concerned and the characteristics of the funds or economic resources made available, including their potential practical use by, and ease of transfer to, the listed entity. The Guidelines clarified that an economic resource will not be considered to have been for the benefit of a listed person or entity merely because it is used by a non-listed person or entity to generate profits which might be in part distributed to a listed shareholder.

On 30 April 2013, a second text was adopted with proposed guidance on the meaning of "ownership or control" for these purposes. That text remains subject to adoption by the Council and therefore has not yet been formally approved. The proposed position is to adopt, as general guidance, the definitions of ownership and control in Council Regulation (EC) No 2580/2001, which imposed sanctions against terrorist groups in the wake of 9/11. Accordingly, "ownership" of an entity is to be presumed where a person owns 50% or more of the proprietary rights of an entity, or has a majority interest in it. "Control" is defined more broadly and may be demonstrated by any of a number of facts including the right to approve a majority of the members of the administrative bodies of the entity, or through a demonstration of control over a majority of shareholders' or members' voting rights. In each case, the presumption may be rebuttable on a case-by-case basis with relevant facts.

The proposed guidance means that there will be a rebuttable presumption that making funds available to a majority owned subsidiary of an EU designated entity will be prohibited. That prohibition will continue to be subject to the general proviso that no liability will be incurred by persons if they did not know, or had no reasonable cause to suspect, that their actions would infringe applicable prohibitions.

Case Law Raises Questions about the Presumption in the Planned Guidelines

Of itself, the clarification would be useful guidance. But pending formal adoption, the position remains unclear, not least because the General Court in one of the recent successful delisting applications came to a different interpretation of the meaning of "ownership or control" in a slightly different, albeit closely related context. In Case T-493/10, an appeal by Persia International Bank plc, the Council had designated Persia Bank Plc on the basis that 60% of its shares were held by Bank Melli, a listed entity. Under the proposed guidelines, this would be sufficient for the presumption of ownership to kick in. But such a

presumption did not hold in this case, said the General Court.

The Court held that while the ownership test would be satisfied where an entity is wholly-owned, a 60% shareholding does not in and of itself lead to the same conclusion. Instead, the Court turned to an analysis of control and found that the 60% interest in share capital was not, in this instance, enough to justify the adoption and maintenance of sanctions.

Although directed at the listing criteria for designated parties rather than a presumption against making funds available to Persia Bank on the basis of its parent ownership, since the impact of the proposed guidance will have a similar effect in many respects (preventing EU persons from making funds available to subsidiaries of designated parties), the Court's conclusion is arguably at odds with the proposed guidance. Although the guidance is made subject to a rebuttable presumption, the decision in this case highlights the difficulty in establishing a clear test for the definition of ownership and control in a manner that would allow for certainty in the market. Given the views expressed by the General Court, it is possible that the proposed guidance could itself be subject to judicial questioning in due course. It remains to be seen both what the Council's position will be on an appeal in the Persia case, if any, and whether the April proposal will in turn be adopted.

The meaning of circumvention – Guidance from the European Court

Another recent EU case of interest is the unsuccessful application made by *Europäisch-Iranische Handelsbank AG* ("EIH") on 6 September 2013, which offers some guidance as to the interpretation of the general prohibitions against circumventing the measures in EU sanctions Regulations. *The standard formula used for such prohibitions in EU Sanctions Regulations is a prohibition against the participation "knowingly and intentionally, in activities the object or effect of which is to circumvent" other sanctions measures referred to in the relevant Regulation.*

In the EIH case, the General Court noted that the circumvention test would be met where "the person participating in an activity covered by those provisions deliberately seeks the object or the effect, direct or indirect, of circumvention connected therewith. They are also met where the person in question is aware that his participation in such an activity can have that object or effect and accepts that possibility."

The applicant had devised a system (the "Third Way procedure"), which enabled a designated entity to discharge a debt due to a creditor in the EU arising from an obligation predating the debtor's designation, by transferring assets for the attention of the creditor via a non-designated, non-EU entity. The Court found that this procedure, in and of itself, would be prohibited as a method of circumvention, unless authorised by a competent national authority.

In its application, EIH attempted to demonstrate that all the transactions which it carried out were authorised by the Bundesbank, excluded from the scope of the prohibition, or carried out in accordance with a procedure approved by the Bundesbank. The Court made a number of observations on these arguments. First, it noted that transactions carried out via a non-designated entity are not automatically lawful. Furthermore, it concluded that a blanket authorisation by the national authority of a process under which transactions that would otherwise be prohibited were entered into was not sufficient. Instead, the Court made it clear that authorisation must be granted on a case-by-case basis.

Furthermore, the requirement for continuous vigilance on the part of financial institutions suggested that "a reasonably diligent financial institution ought to have requested more information about the 'approval' received". It follows from EIH's unsuccessful application that each transaction between a financial institution and a non-designated entity that could have the possibility of being a circumventing activity will require specific authorisation by the relevant national authority. In addition, the Court made it clear that it is the responsibility of the relevant financial institution to be vigilant and to ensure that the approval received is specific to the terms of the transaction in question.

EU cases annulling designations – Limited practical consequences

Over the last few months, various entities have won applications in the European Courts to annul their designations as sanctions targets, almost all of which have been under the Iranian sanctions regime. In each of the successful cases, the appeals were won on procedural grounds with the Court holding that, among other reasons, the Council of the European Union either did not have sufficient evidence to support its reasons for designating the relevant parties or was not prepared or able to release that information.

But in most of the successful cases, any victory for the parties involved may turn out to be short-lived, as the Council has since published new measures re-listing the majority of the previously designated parties and giving new reasons. As a result, and despite the publicity, the consequences for compliance professionals have largely been minimal as most of the relevant entities (including the Islamic Republic of Iran Shipping Lines and various its subsidiaries, as well as Persia International Bank Plc, Export Development Bank of Iran and the Iranian Offshore Engineering & Construction Co.) have either remained on the sanctions lists pending appeals or have been re-listed during that period.

It is important to be aware that the handing down of an EU judgment which annuls the listing of an EU designated party does not mean that it is safe to start trading with or making funds available to such an entity. The orders annulling listings do not take effect until the expiration of the 2 month period for an appeal on the judgment to be lodged (2 months and 10 days from the date of the judgments) and in the meantime, the prohibitions remain in place until the relevant EU Regulation is itself amended or annulled. In many cases, as seen above, the parties could be re-listed in a compliant manner before the annulments would otherwise take effect.

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