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soundings

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The purpose of this note is to briefly review the likely effect of the new Iran Sanctions regime.

Background

Concern over Iran's nuclear power programme has grown over recent years, and has resulted in a number of measures being taken. In October, 2009 the UK Government enacted the Financial Restrictions (Iran) Order 2009 which prevented any companies operating in the UK financial sector from entering business relationships with two named entities – an Iranian bank, and the Islamic Republic of Iran Shipping Lines, known as IRISL. Earlier this year the UN Security Council increased the range of existing sanctions against Iran.

However, the United States has now gone further than all of this with the implementation of the Comprehensive Iran Sanctions, Accountability and Divestment Act 2010, which came into force on 1st July, 2010. This Act dramatically widens the range of parties that may be affected by the sanctions regime and has effects that may extend far beyond the United States.

The Act

The US sanctions seek to disrupt "business activities in the energy sector of Iran which may directly or indirectly support the Government of Iran to achieve nuclear weapons capability". As Iran has limited refining ability and needs to import refined petroleum products, the sanctions have been drafted to restrict the provision of goods, or services that could maintain Iran's refineries and also to restrict Iran's ability to import refined petroleum products.

Under the Act, the United States government can impose sanctions against any company which knowingly sells, leases or provides goods, services, technology or support in respect of refined petroleum products which have a fair market value of $1 million, or a total of $5 million in a 12 month period. Goods and services are specifically defined to include "providing ships or shipping services to deliver refined petroleum products to Iran."

The sanctions which can be imposed against any company in breach of the Act include a denial of access to the US banking system and foreign exchange – which effectively amounts to a prohibition from trading in US dollars. A further penalty is being banned from property transactions in the US, which would affect any company with a US subsidiary or relationship with a US company. Furthermore any company engaged in governmental contracts is required to certify that it is not engaged in any proscribed activities. Criminal penalties for breach have been increased to US$1 million and a jail term of up to 20 years.

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Sanctions on Iran – potential impact on Members (continued)

There are a number of waiver provisions in the Act. For instance, there is an exception for companies providing underwriting services if the US government is satisfied that due diligence has been exercised to ensure that what is being insured is not a proscribed activity. However it is unknown how these waivers will be applied, and more significantly how the Act will be interpreted and enforced by the US government. Guidance is expected to be issued shortly by the US Treasury in this regard.

Impact on charterparties
The inclusion of shipping services within the list of restricted activities will be of concern to owners and charterers alike, particularly given the extra-territorial scope of the Act. Much will depend on how the US government intends to implement the Act, however the following provides initial guidance.

(i) Existing charterparties
Charterparties that do not exclude Iran as a trading option could present an awkward problem if an owner was ordered to carry a refined petroleum cargo to Iran. Refusing such an order could be deemed to be a breach of the charterparty, yet performing the order could result in a ban on trading US dollars for the foreseeable future, amongst other sanctions.

As the US sanctions include the ability to have funds passing through New York frozen this could potentially catch hire or freight. There is an argument that this would frustrate a charterparty under English law, as one of the main purposes of the charter would be impossible to perform. Another argument is that the imposition of the sanctions would make shipping a refined petroleum cargo to Iran a "supervening illegality" permitting the owner to refuse the order. Some charterparties may include other terms that would be relevant such as a force majeure clause or war risks clause. There is however no easy answer and each charterparty will have to be assessed on its own terms.

Where existing charterparties exclude trading to Iran, it might be considered that the Act presents no issues. However the parties will need to consider whether the cargo might be transhipped to Iran or whether the ship might be re-let to any organisation that has any trading link with Iran.

(ii) New charterparties
Clearly it would be prudent for any new charterparties to take account of the sanctions. Intertanko had drafted a clause in response to an earlier draft of the legislation. This clause permits an owner to refuse orders which could expose the ship to a risk of sanctions. However this was viewed by many charterers as being too draconian, and the clause may well be revised now that the final Act has been signed by President Obama. Bimco has also very recently produced a more general Sanctions Clause for Time Charterparties.

Members having specific questions should consult with your usual Club contact.

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