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**Meeting Summary: International Law Programme**

# International Sanctions: Complexities and the Impact on European Business

**This meeting was organized in association with Freshfields Bruckhaus Deringer LLP.**

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## INTRODUCTION

The sanctions imposed by the UN and EU against Iran in 2010 marked a dramatic extension of the international sanctions regimes against a variety of states. The speakers considered the sanctions regimes, along with their overall impact for European business and some of the unanticipated consequences and complexities that have emerged as the regimes have come into operation.

The participants included practising lawyers, academics and representatives of government and of business.

This meeting was held under the Chatham House Rule.

*The UN Panel of Experts and its Role*

The UN Panel of Experts was created under UN Security Resolution 1929 (2010). The Panel works to the direction of the 1737 Committee and advises the UN Security Council (UNSC) on the implementation of sanctions on Iran. The Panel's responsibilities include gathering, examining and analysing information relevant to implementation of sanctions and providing a series of reports within its mandate. These belong to the Security Council. The Panel has held consultations with member states and conducted inspections of violations. The Panel is also involved in outreach and participates in seminars to explain the role of sanctions and the role of the Panel.

*Sanctions on Iran*

Iran and the Democratic People's Republic of Korea (DPRK) are the two countries on which the UN currently levies sanctions for their proliferation programmes. In the case of Iran, there are four UN Sanctions Resolutions, the first being Resolution 1737. This was implemented by the UNSC in 2006 for Iran's non-compliance with safeguards obligations under the Nuclear Non-Proliferation Treaty (NPT). There have been three subsequent resolutions, which build upon the previous sanctions in the extent and depth of the measures.

The important point about sanctions against Iran is that they are targeted and not comprehensive. The problems with comprehensive sanctions were highlighted by the experience of sanctions against Iraq. The sanctions against Iran are clearly targeted towards nuclear and missile programmes, import and export of conventional weapons and Islamic Revolutionary Guard Corps (IRGC) and the Islamic Republic of Iran Shipping Lines (IRISL) where they are connected with the above. They are focused and apply under certain conditions to sectors of economic activity: exports to Iran of materials or manufactured goods; shipping, transport and related areas (e.g. insurance); finance and business; individual travel restrictions; restrictions on technical assistance, teaching or training. UN sanctions do not deal with the energy sector although there is reference in a pre-ambular paragraph of resolution 1929 (2010) to the possible importance of the energy sector in providing funding for sensitive nuclear activities. There are designations of entities or individuals amongst the four resolutions: 76 entities and 43 individuals are named and there are control lists for sensitive items, the lists being generally taken from Nuclear Supplies Group (NSG) or Missile Technology Control Regime (MTCR) lists that were current at the time.

*What are the policy objectives behind sanctions regimes?*

The policy objectives behind each sanctions regime are different but they are typically focused on changing the behaviour of a regime – usually behaviour that is a threat to international peace and security or that constitutes a serious violation of human rights. When assessing sanctions it is also important to manage expectations. Sanctions are playing a role in some of the most difficult foreign policy issues of the day – these are enormously complicated issues that are not going to be solved on their own by sanctions. However, sanctions can and do make a contribution to policy objectives.

The objectives of the resolutions targeted at Iran can be summarized as: 1) part of a dual-track policy by the international community to persuade Iran to negotiate in

good faith over its nuclear programme and persuade Iran to be transparent about its past programmes; 2) to slow Iran's programmes of concern. Sanctions are a major part of the UK Government's dual track strategy of pressure and engagement. Their ultimate objective is to encourage a resumption of serious dialogue with Iran that leads to a peaceful and negotiated solution to the nuclear issue. For Syria the objective is also clear –an end to violence and a transition to a stable, more democratic country.

Sanctions, at a very basic level, aim to change the behaviour of a regime. They can do this by:

- sending a message to the target, and to potential imitators, that the international community condemns their actions;
- raising the cost of pursuing a course of action or disrupt an activity such as proliferation;
- showing reformers inside a country that they are not alone;
- providing an alternative to force when responding to an incident;

Kofi Annan puts this final point another way:

*'In dealing preventively with the threats to international peace and security, sanctions are a vital though imperfect tool. They constitute a necessary middle ground between war and words when nations, individuals and rebel groups violate international norms and where a failure to respond would weaken those norms, embolden other transgressors or be interpreted as consent.'*[1]

Finally, the offer to suspend or lift sanctions measures can be used as part of a bargaining process with the target. There is clear evidence of this in South Africa, Libya in 2003 and most recently in Burma.

*Financial Sanctions:*

Targeted financial sanctions require freezing of funds and other assets of certain entities and individuals. Each resolution includes lists of these entities and individuals.[2] Currently, two Iranian financial institutions are designated:

- Bank Sepah and Bank Sepah International (resolution 1747 (2007)) and
- First East Export Bank (resolution 1929 (2010);

Activity-based sanctions impose restrictions on financial or business dealings with Iran under certain conditions. In summary, they include requirements to:

- Prevent transfer of financial resources or services related to supply, sale, transfer, manufacture and use of the prohibited items, materials, equipment, goods and technology specified;

[1] The 2005 report of the UN Secretary-General's High-level Panel on Threats, Challenges and Change to the UN, cited at http://www.un.org/secureworld/report2.pdf, p. 55.

[2] Combined list: http://www.un.org/sc/committees/1737/ consolist.shtml

- Prevent provision of financial services and transfer of financial assets or resources which could contribute to Iran's proliferation-sensitive nuclear activities or the development of nuclear weapon delivery systems;
- Prohibit Iranian banks from initiating new business activities in Member States if related to Iran's proliferation-sensitive nuclear activities or the development of nuclear weapon delivery; and
- Prohibit financial institutions of Member States from initiating new business in Iran if related to Iran's proliferation-sensitive nuclear activities or the development of nuclear weapon delivery systems.

States are required to '[…] exercise vigilance over the activities of financial institutions in their territories with all banks domiciled in Iran, in particular with Bank Melli and Bank Saderat, and their branches and subsidiaries abroad […]'.[3] Vigilance over transactions involving Iranian banks, including the Central Bank of Iran, is called for in pre-ambular paragraph 16 of resolution 1929 (2010). States are obliged to require their nationals, persons and companies to exercise vigilance when doing business with entities in Iran including those of the IRGC and IRISL.

*Need for Information*

The 1737 Committee and the Panel need information on implementation of UN sanctions on Iran from states and other relevant bodies. This information helps in analytical work and informs the recommendations included in the Panel's final reports.

*Implementation of Sanctions in the UK:*

The Treasury is responsible for the implementation of financial sanctions in the UK. The sudden growth in sanctions poses the question how they have evolved over a longer period of time. It is therefore useful to look back to the origin of sanctions, particularly when they were first used as a tool of foreign policy. It is possible to trace them back to at least the first decade of the Nineteenth Century – during the Napoleonic wars.

In the UK, the FCO leads on sanctions policy, but the provisions are implemented by a number of departments across HMG including HM Treasury, UK Business Advisors (UKBA), UK Department for Business, Innovation and Skill (BIS) and Department of Energy and Climate Change (DECC). Certainly the most popular sanctions in recent years are financial sanctions. Individual sanctions are formulated in the first instance through discussions within the UNSC. Following negotiations, there is an agreement which consequently translates itself into resolutions.

*How is sanctions policy formed?*

The starting point is the objective of the sanctions regime, which will influence the scope of the measures. If the target is proliferation sensitive activities, early rounds of sanctions are likely to include export controls on dual use goods. If the target is

[3] http://www.hm-treasury.gov.uk/d/unscr_1803_030308.pdf

individuals responsible for human rights abuses, a list of those within a regime or militia groups, identified as being responsible for violence might be drawn up. It is also important to consider tension between more and less targeted sanctions. Research by the Peterson Institute[4] indicates that it's the latter – i.e. those that impact their target with a greater percentage of GDP – that are more likely to be successful.

One may therefore question why there are not more comprehensive sanctions policies. The answer is the impact on third parties, most importantly the civilian population. This is obviously a major consideration for policy makers in Government, particularly when the target country is facing a humanitarian crisis. But these are finely balanced decisions - compelling concerns over the impact on third parties must be very carefully weighed against the cost of inaction, which also impacts the civilian population and other third parties.

So much of sanctions policy making is focussed on finding ways of minimising these risks. To do this requires cross-departmental working and careful co-ordination with our international partners. Sanctions will be most effective when implemented as consistently possible in as many jurisdictions as possible. Industry engagement, through events such as this, is also critical.

*After the adoption of sanctions*

As soon as sanctions take effect the Treasury has responsibility for implementing the financial elements of the package. Broadly there are two objectives when implementing sanctions – to maximise their impact on the target, and to minimise the impact on third party interests. An assets freeze, for example, contains a number of exceptions and licensing grounds under which the Treasury can permit certain categories of payments to be made.

To ensure that the sanctions were implemented robustly, and in a way that reduced the impacts of sanctions on innocent third parties, the Treasury has also taken an active approach to licensing. This approach was coordinated with other countries. As a result, the Treasury granted a wide range of exemptions licences under the Libya sanctions to:

- meet humanitarian needs;
- allow the Libyan banks in London to continue operating;
- enable legitimate business transactions to continue where the transactions would not benefit the Gadhafi regime;
- protect the value of frozen Libyan assets, for example by allowing them to be actively managed; and
- allow other legitimate payments, for example payments of salaries and fees for Libyan students in the UK.

[4] Schott, J Economic Sanctions Reconsidered http://bookstore.piie.com/book-store/4082.html

*The future*

Firstly, it is remarkable that the international community has agreed to such ambitious packages of sanctions over the course of the past year – particularly those against Iran. The challenge is now to ensure they are implemented effectively in all jurisdictions, particularly given the difficult economic climate in which these sanctions have been agreed. If we can meet that challenge then two things happen – sanctions become more effective, and we create a level playing field - reducing the risk of sanctions arbitrage.

Secondly, it is important to ensure that new sanctions proposals are scrutinised – particularly quantifying their cost. Businesses are crucial to the process of implementing sanctions. They provide feedback where such businesses suspect that they are being circumvented.

## How sanctions have an impact on business

Sanctions pose a unique challenge to businesses. Sanctions are political which means that different countries take very different approaches to them and at times can be unpredictable. European businesses have had to comply with export control orders and assets freezes for many years. Previously, compliance with sanctions was focused on banks. Particular sectors, such as the defence industry and those with significant US business, focussed on Office of Foreign Asset Control (OFAC) sanctions with little regard the to the EU/UK sanctions. This has emphatically changed.

The introduction of the new UN and then EU sanctions against Iran in 2010 almost certainly marked the turning point for the significance of EU/UN sanctions for businesses. The 2010 Iranian sanctions constituted the most extensive and complex sanctions imposed on European business. They specifically drew in certain sectors such as the petrochemical and insurance industries imposing requirements that went beyond the previous asset freezes.

The EU sanctions were deliberately wide-ranging and highly engineered. The stated intention was that legitimate business should be allowed to continue and not to harm EU business in the face of competition from those not prohibited from dealing with Iran. However, their breadth and complexity meant that companies had to devote significant time and resources to ensure compliance with them and protect existing business. For a company previously doing business in Iran it became necessary to:

- implement the extended assets freeze and provide information to the competent authority.
- Work out what was covered by the prohibition on the provision of ‘technical assistance’ or ‘financial assistance’ and the extent of the prohibition on provision of ‘economic resources’.
- Having identified pre-existing contracts that were caught, notify those contracts to the authorities under the grand-fathering provisions 20 days prior to performance;

- ensure the necessary steps were in place to allow payments to be received or made to Iran to comply with the notification and authorisation processes;

- confirm whether insurance contracts were still in place and the state of any financing.

- If necessary, obtain licences to protect pre-existing payment streams.

All of the issues above needed to be addressed quickly, and significantly increased the level of bureaucracy around legitimate business and the cost of doing business.

In addition, the sanctions measures introduced by the EU in 2010 were different from those imposed by the US. It was very clear that EU businesses could no longer rely on being solely OFAC-compliant.

As a consequence, some businesses had to invest significant resources around due diligence and to engage an EU compliance officer or to ensure that someone in the business has specific responsibility for compliance. More fundamentally, a decision had to be taken whether to continue to do legitimate business with Iran at all. The costs of compliance and the risk of getting it wrong when trying to walk the line through the complex and unaligned international sanctions regimes resulted in a number of clients withdrawing from Iran completely. A large number of banks (even before the UK prohibition introduced last November) had decided not to process any Iranian payments which makes doing business with Iran, at the very least, uneconomic, if you cannot receive payment for services rendered.

Further, this raises the interesting conundrum that having introduced targeted sanctions, businesses themselves have imposed more of a blanket ban. This is consistent with UK guidance but not for all EU countries, and it has implications not only for legitimate business but humanitarian aid. As regards the US crude oil embargo, this was done when the EU had resisted such an embargo. Interestingly, in the case of the Iranian embargo, the EU Regulation permits a grandfathering of not only existing shipments but also ancillary contracts necessary for the shipment (so, for example, the provision of insurance and trade credits). This has evolved from the Syrian embargo where grandfathering of the shipping contracts had been permitted but not, without a specific licence, related insurance or financing. The provision of insurance to Iranian companies is prohibited. That now extends expressly to the provision of brokering services.

Currently, there is a move to consider the specific complexities that companies face when trying to ensure compliance with international sanctions regimes. Many companies would like to design and implement a global sanctions policy. This is problematic as, unlike bribery and corruption policies, sanctions are very specific. In some cases, sanctions conflict with each other. For example, in Cuba, the US imposes extraterritorial sanctions and the EU has made it a criminal offence to comply with these sanctions. Thus, it is simplest to comply with sanctions on a case by case basis and attempt to comply in each country.

Sanctions can be imposed very quickly. This was evidenced with respect to the sanctions imposed against Libya. These were imposed over a weekend and

businesses needed to absorb the implications of those sanctions (where there was no grandfathering) and take action. Here, implementation was not easy and the extent of the assets covered was unclear.

It is exceptionally important to companies when they review sanctions to understand the extent of them and how they can operate within them, as this is not always consistent. Implementation is made difficult because of the lack of clear guidance. Guidance is not always consistent across the EU either. There is also a lack of clarity in sanctions legislation. There is a lack of clarity in how sanctions are drafted; this in itself poses problems for implementation. This increases the number of informal enquiries to the authorities and the formal applications for licences/exemptions. Given the bureaucracy behind granting a licence from EU/UN sanctions, increasing numbers of applications meant significant delays and lead times.

Many other questions arise such as dealing with subsidiaries of designated persons such as, who is covered and what is the situation where subsidiaries are not specifically mentioned? Further, the question was raised how does this interact with the concept of 'owned or controlled by'? The lack of clarity means that businesses are required to invest in more sophisticated due diligence, using, for example, World Check. There is also difficulty in identifying subsidiaries in countries where corporate information is not reliably in the public domain or, in the case or IRISL, where there is a campaign of deliberate circumvention.

One must also question what amounts to 'circumvention'? There are evident differences between the UK and EU position. The offence in the EU Regulation is 'to participate knowingly and intentionally in activities the object or effect of which is to circumvent these provisions.'[5] The UK offence goes further, referencing 'facilitating' and 'enabling.' There is some guidance from the ECJ in *Afrasiabi* [6] which held that to commit the offence you must have intention of frustrating the prohibition or be aware that you may have that effect and accept the possibility.

Finally, the impact of banks' internal policies was highlighted. The US has stepped up pressure on non-US banks to discourage them from dealing with Iran. There is a lack of recourse against banks that refuse to undertake lawful transactions given the breadth of their contractual discretion in their terms and conditions.

## Discussion

*The distinction between UN sanctions and non-UN unilateral sanctions*

In previous years, it has been said that non-UN sanctions imposed by a state unilaterally could amount to illegal intervention in a country's internal affairs. From an international law perspective, it used to be a concern that a country could extra-territorially impose their own law on third states' nationals as the US is doing in Cuba. However, recent actions of states are suggestive of acceptance of such unilateral sanctions.

[5] Article 3 (e) Council Regulation (EU) No 296/2011 of 25 March 2011 amending Regulation (EU) No 204/2011 concerning restrictive measures in view of the situation in Libya

[6] Case C-72/11: Judgment of the Court (Third Chamber) of December 2011: Cited at - http://www.iranwatch.org/government/eu-thirdchambercourt-afrasiabi-122111.pdf

*Degree of enforcement action concerning the EU blocking regulations*

In November 1996, the European Union adopted two measures in order to address issues of extra-territoriality of US law.[7] Canada and Mexico have also enacted 'blocking' laws to prevent the extraterritorial aspects of US economic sanctions against Cuba. However, as it stands, there has been no enforcement action from BIS or the Treasury on the EU blocking regulation. Many businesses are conflicted as to whether to comply with the US sanctions or the EU blocking regulations themselves. It seems that in relation to Cuba and the Helms-Burton Act, the international community appears to be, to put it simply, 'going along with it.'

Although there has been no enforcement of the blocking legislation in the UK, there has enforcement action in Austria which involved enforcement against the bank BAWAG PSK, in April 2007.[8] In the UK, BIS sends out letters to remind parties of the EU blocking legislation and to warn them that they are in breach of it. It has become a political issue for companies who have been seen to have complied with US sanctions against Cuba, in violation of UK law.

*Advice for businesses?*

Currently if a business is operating in the UK and UK law states it would be a criminal offence to, for example, import crude oil from Iran, the company would be well advised to comply with this, whether or not the sanction had been imposed unilaterally by the UK; it would amount to a criminal offence not to comply. It is evident that businesses are not willing to take the international law question through the courts up to European level.

*Do states' actions in relation to Iran represent accession to unilateral sanctions?*

Recently, the United States granted 11 countries (including 10 European Union nations) exemptions so that they can trade in certain products, including oil. It is thought by some that the fact the countries feel the need to go to the US to ask for specific exemptions is representative of their acquiescence in these unilateral sanctions. There appears to be some sort of acquiescence with regard to these unilateral sanctions that did not exist with previous US unilateral sanctions regimes, for example, the sanctions in relation to Cuba. It is a political question as to why it is being allowed. International law could come to the aid of countries that don't want to comply with US sanctions. So far, this is not happening. It may be the toxicity of the Iranian regime which prevents states from challenging these US unilateral sanctions. There seem to be special qualities in relation to the relationship with Iran that doesn't apply in other sanction situations.

This might be regarded as a quasi-modification of the rule against unilateral sanctions that interfere with third party country and seem to be in violation of the free trade principles of the World Trade Organisation.

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[7] Council Regulation (EC) 2271/96 (also known as the 'Blocking Statute') & Joint Action 96/688

[8] The most publicised case is that of Austria's enforcement action against one of its largest banks, BAWAG PSK, in April 2007. Austria brought the action because BAWAG breached the EU blocking law by closing the bank accounts of Cuban nationals. This followed a press statement claiming that the account closures were required in order to allow the completion of BAWAG's acquisition by Cerberus Capital, a US private equity firm. This was ultimately resolved by OFAC granting a limited authorisation to BAWAG in the form of a licence.

Businesses are in a very difficult position as they are hit by all sets of sanctions. Consequently, as an industry voice pointed out, businesses want to play it safe and will stop doing business creating risks, in order to maintain their reputation, particularly in the US.

*Supporting practical implementation of the sanctions regimes*

It was suggested that it would help the implementation process if the process was more streamlined and coherent. As previously discussed, implementation of sanctions is uneven. There is a huge variation in terms of capacity of governments. Thus, with regard to implementation, the importance to increase regulatory transparency is crucial. Industry are spending huge amounts of money on trying to put in place sufficient screening programmes but most are still in the dark as to what is expected. UN sanctions would appear to be slowing the nuclear programmes. While by themselves they might not bring Iran to the negotiating table, if they were uniformly implemented they would have more of an impact.

*Review Mechanisms: Are they effective?*

It was questioned whether the existing mechanisms to review the targeting of specific individuals and companies are sufficient. They are crucial in this process as businesses are not only affected by sanctions, but can also have sanctions placed against them or have to deal with those who are targeted by sanctions.

There is now an ombudsperson to deal with counter-terrorism sanctions which has been put in place as the European Court of Justice criticized the Security Council for not adhering to due process standards for those who are targeted. It was only in direct response to litigation that the process was developed. Although the ombudsperson is effective in gathering evidence, her powers are still fairly limited and cannot make binding recommendations to the Security Council. The process does not represent an effective judicial review, despite the requirement that the UN should comply with human rights. Nor does the process apply to sanctions other than those on counter-terrorism.

There can be said to be some kind of a review process for all sanctions in that each sanctions committee chairman presents a report to the Security Council on the activities of the committee. This in itself presents an opportunity for the Security Council to review the particular sanctions regime as a whole.

So far as EU sanctions are concerned, it was noted that sanctions are reviewed every year and must be voted on to be rolled over for another year. Importantly, it is possible to challenge listings and there are a significant amount of challenges of listings at European level. But a successful challenge resulting in removal from a unilateral EU list will only get you so far, since companies are generally on more than one list. Even those who are legitimately delisted from the UK process still find that they have difficulty elsewhere doing business. It is difficult to challenge a bank's decision to accept a payment. The banks have absolute discretion and if a company is on any list, there is a possibility they will struggle to process completely legitimate payments; there is currently no recourse against this decision.