

NDAA 2013: A POTENTIAL EXPANSION OF U.S. SANCTIONS AGAINST IRAN AS OF JULY 1, 2013

The National Defense Authorization Act for Fiscal Year 2013 (“NDAA 2013”) was enacted on January 2, 2013, and contains a subtitle, the “Iran Freedom and Counter-Proliferation Act of 2012” (“IFCA”), that sets out additional sanctions against foreign persons engaged in trade with Iran. IFCA takes effect on July 1, 2013, and has potentially far-reaching impact as it targets a wider range of activities than current sanction programs which are largely directed to Iran’s petroleum and petrochemical industries. To provide further clarification on how IFCA might be applied, the U.S. Treasury Department’s Office of Foreign Assets Control (“OFAC”) issued guidance on June 3, 2013, regarding the implementation of IFCA. Additionally, on June 3, 2013, President Obama signed an Executive Order (“E.O.”) which clarifies the types of penalties that can be imposed for violations of IFCA.¹

Insofar as those involved in marine transportation and insurance are concerned, the more salient aspects of IFCA, as clarified by OFAC and the June 3, 2013 E.O., include the following.

IFCA §1244: Transactions Involving Iran’s Energy, Shipping & Shipbuilding Sectors, Iranian Ports, or Iranians on the Specially Designed Nationals (“SDN”) List

Transactions with Iran’s Energy, Shipping and Shipbuilding Sectors and its Ports

Declaring that Iran’s “energy, shipping, and shipbuilding sectors” and its ports are facilitating Iran’s nuclear proliferation activities, IFCA imposes sanctions directed against transactions benefitting those industries. This section presents perhaps the most significant aspect of IFCA insofar as marine transportation is concerned.

¹ The June 3, 2013, E.O. is entitled “Authorizing the Implementation of Certain Sanctions Set Forth in the Iran Freedom and Counter-Proliferation Act of 2012 and Additional Sanctions With Respect to Iran.” In addition to clarifying the penalties under IFCA, the E.O. imposes new sanctions against anyone (including foreign persons) who (after July 1, 2013) knowingly engage in a “significant” transaction for the sale, supply, or transfer to Iran of “significant” goods or services used in connection with the “automotive sector of Iran” defined to mean “the manufacturing or assembling in Iran of light and heavy vehicles ...as well as original equipment manufacturing and after-market parts manufacturing relating to such vehicles.” Given the definition of “automotive sector,” it is believed that the transport of fully-assembled automobiles to Iran would not violate the E.O.

The June 3, 2013, E.O. also revises E.O. 13622 that was signed in July 2012 and imposed sanctions with respect to Iran’s petroleum and petrochemical industries. (See prior published FAQ #14). In its current wording, E.O. 13622 imposed sanctions for anyone who knowingly engaged in a “significant transaction for the purchase or acquisition” from Iran of petroleum, petroleum products, or petrochemical products. While the E.O. did not specifically refer to transportation or shipping services, it was believed that the E.O. would be interpreted to capture such activities within its scope. The revision to this E.O. announced on June 3, 2013, now makes that interpretation clear as it expands the reference to “purchase or acquisition” to include “purchase, acquisition, sale, transport or marketing.”

Specifically, IFCA imposes sanctions against any person who “sells, supplies, or transfers” to Iran “significant goods or services used in connection with the energy, shipping, or shipbuilding sectors of Iran”, which is defined to include NIOC, NITC, and IRISL.² Persons are also subject to having their property in the U.S. blocked (which includes wire transfers in U.S. dollars) if they provide “significant” financial, material, technological, or other support to, or goods or services in support of any activity or transaction on behalf of or for the benefit of any person determined to be a part of the energy, shipping, or shipbuilding sectors of Iran or determined to operate a port in Iran.³

In its recent guidance, OFAC confirmed that in determining whether conduct is “significant” as described in IFCA,⁴ a number of factors will be considered including size, number and frequency; type, complexity and commercial purpose; the level of awareness of management and whether such conduct is part of a pattern of conduct; the ultimate economic benefit conferred upon the sanctions target, and other relevant factors. The inquiry will thus be factually-driven, which gives the authorities wide latitude in determining when conduct is “significant.”

At first blush, these sanctions appear to be quite broad as the references to Iran’s “energy, shipping or shipbuilding sectors” and its “ports” are not defined and, at least with respect to the “shipping sector” and “ports” references, they can conceivably capture all manner of maritime activity into and from Iran including transactions with agents, terminals, and the like. However, in its recent guidance, OFAC indicated that it anticipates regulations will be enacted defining those sectors as follows and also describing the types of goods and services that will be deemed “in connection” with these sectors.⁵

- **“Energy sector”**

- Anticipated to be defined to “include activities involving the exploration, extraction, production, refinement, or liquefaction of petroleum, natural gas, or petroleum products in Iran.”
- Anticipated to describe prohibited goods and services as those that contribute to (i) Iran’s ability to develop its domestic petroleum resources; (ii) the maintenance or expansion of Iran’s domestic production of petroleum products; and (iii) Iran’s ability to import or export petroleum or petroleum products.

² IFCA §1244(d).

³ IFCA §1244(c).

⁴ Notably, unlike other sanction programs, IFCA does not specify monetary thresholds before conduct gives rise to sanctions, using instead the more amorphous phrase “significant.”

⁵ OFAC further advised that it will identify on the SDN list those persons determined to be part of Iran’s energy, shipping or shipbuilding sectors, or a port operator in Iran, for purposes of §1244. **However, this list will not be exclusive, and a person still may be subject to sanctions regardless of whether an entity is specifically identified on the SDN list.**

- ***“Shipping sector”***
 - Anticipated to be defined to “include activities involving the transportation of goods by seagoing vessels, including oil tankers and cargo vessels, flying the flag of the Islamic Republic of Iran, or owned, controlled, chartered, or operated directly or indirectly by the Government of Iran.”
 - Anticipated to describe prohibited goods and services as (i) the provision of crude and product tankers to Iran; (ii) the provision of registry, flagging or classification services of any kind; (iii) supervision of and participation in the repair of ships and their parts; (iv) inspection, testing, and certification of marine equipment materials and components; (v) carrying out of surveys,⁶ inspections, audits and visits, and the issuance, renewal or endorsement of the relevant certificates and documents of compliance; and (vi) any other goods or services relating to the maintenance, supply, bunkering, and docking of vessels flying the flag of Iran, or owned, controlled, chartered, or operated directly or indirectly by, or for or on behalf of Iran or an Iranian person.

- ***“Shipbuilding sector”***
 - Anticipated to “include activities involving the construction of seagoing vessels, including oil tankers and cargo vessels, in Iran.”
 - Anticipated to describe prohibited goods and services as (i) the building and refit of vessels; (ii) the provision or refit of items such as steam turbines, gas turbines, and engines and their parts; propellers and blades, and direction finding compasses and other navigational instructions and appliances solely for the maritime industry; (iii) other goods used in connection with building and propulsion of vessels; and (iv) technical assistance and training relating to, and financing of, the building, maintenance or re-fitting of vessels.

Given this guidance, it appears that the “shipping sector” aspect of §1244 is designed to target activities that relate to Iran’s ability to engage in ocean transportation itself. The anticipated regulation defining the “shipping sector” is not limited exclusively to such activities by Iran, as the intended definition speaks in terms of “including” these activities. Nonetheless, the definition gives insight into how the “shipping sector” aspects of §1244 will be interpreted, and based on this guidance, it would seem that §1244 is not intended to sweep as broadly as may appear on its face and instead is designed to hamper Iran’s ability to transport goods on ships owned, chartered, operated or controlled by it in any manner. Extreme caution should therefore be exercised in chartering out vessels to insure that Iran is not behind a layer of companies.

⁶ Given the context in which “surveys” is mentioned, it seems that these prohibitions would not encompass P&I surveys related to an insured event, although those types of surveys are not specifically excluded. Nevertheless, caution should be exercised to ensure any P&I surveys conducted do not relate to an underlying transaction that otherwise violates any sanctions program directed at Iran.

With respect to the §1244 sanctions for significant transactions on behalf of or for the benefit of any port operator in Iran, the recent guidance from OFAC provides little clarification as to how that provision will be implemented. The provision can, on its face, be broadly construed to encompass a wide range of transactions with a port. However, the State Department and OFAC have advised informally that, at this time, routine calls to Iranian ports with non-sanctionable cargo would generally not fall within the scope of providing significant support to an operator of an Iranian port.

Transactions with Those on the Specially Designated Nationals (“SDN”) List

In addition to the above, §1244 imposes sanctions on any person who provides “significant” goods and services to or for the benefit of any Iranian person on the SDN list.⁷ OFAC has advised that it anticipates publishing on its website a list to assist in identifying Iranian persons included on the SDN list. Therefore, it would be advisable for those engaged in international commercial activities to check this list on a regular basis to ensure that parties with whom they are contracting, or the parties who are benefiting from the goods and services provided, are not listed on the SDN list as an Iranian entity/person.

Exceptions to the §1244 Sanctions

IFCA contains a number of exceptions from the scope of its sanctions targeting the energy, shipping and shipbuilding sectors, Iranian ports, and Iranian SDNs, including the following:

- Humanitarian assistance: transactions for the sale of agricultural commodities, food, medicine or medical devices to Iran or for the provision of humanitarian assistance.⁸
- Petroleum and petroleum products: the export of petroleum (*i.e.*, crude) or petroleum products from Iran to a country which holds an NDAA waiver (currently 20 countries).⁹
- Natural gas: transactions for the sale, supply or transfer to or from Iran of natural gas.¹⁰
- Pipeline activities: certain activities relating to the pipeline project to supply natural gas from the Shah Deniz gas field in Azerbaijan to Europe and Turkey.

IFCA §1245: Transactions Involving Precious Metals and Raw Materials

Section 1245 of IFCA provides¹¹ for sanctions for a person who knowingly “sells, supplies, or transfers [including transshipment], directly or indirectly to or from Iran” the following:

- A precious metal; or

⁷ IFCA §1244(c).

⁸ IFCA §1244(e).

⁹ IFCA §1244(g).

¹⁰ IFCA §1244(h). Section 1244, however, does set out sanctions that may apply to “foreign financial institutions” (which generally does not include an insurance company or underwriter) under certain circumstances.

¹¹ See IFCA §1245.

- Graphite, raw or semi-finished metals such as aluminum and steel, coal, and software for integrated industrial processes¹² if:
 - Iran is using those materials as a medium for barter, swap, or any other exchange or transaction, or listing those materials as assets of Iran for purposes of its national balance sheet; or
 - The material is (i) to be used in connection with the energy, shipping or shipbuilding sectors of Iran or any sector of Iran's economy determined to be controlled directly or indirectly by Iran's Revolutionary Guard Corps; (ii) sold, supplied or transferred to or from an Iranian person on the SDN list; or (iii) to be used in connection with Iran's nuclear, military or ballistic missile programs, as determined by the President.

This provision poses a potential risk of sanctions with respect to any carriage of such materials as this section does not use "significant" as the applicable standard for assessing whether a transaction is sanctionable. Accordingly, caution should be exercised in any transactions involving the carriage or transport of these materials.

Further, caution should be exercised in any transaction involving these materials because it may not be readily apparent whether the materials are intended for use in the "energy, shipping or shipbuilding sectors of Iran," although OFAC's June 3, 2013, guidance on the anticipated meaning of these terms provides some clarification that will be useful in evaluating whether a contemplated transaction might run afoul of §1245. Similarly, OFAC has indicated that a report will be published in the Federal Register by July 1, 2013, discussing which sectors of the Iranian economy are controlled directly or indirectly by Iran's Revolutionary Guard. This report should provide further guidance to assessing whether a transaction might give rise to sanctions under §1245.

Persons will not be subject to sanctions under §1245 if they exercise "due diligence" in establishing and enforcing policies, procedures and controls to ensure that they do not engage in the prohibited activities.¹³ The statute does not further clarify what level or type of diligence will satisfy the exception, and OFAC has only confirmed that due diligence will be determined on a "case-by-case basis as part of an investigation or enforcement action."

¹² In its June 3, 2013, guidance, OFAC stated that it anticipates regulations to be promulgated defining the materials within the scope of §1245 as including a vast array of metals and their alloys such as steels, aluminum, cobalt, copper, graphite, magnesium, nickel, plutonium, silver, titanium, uranium, and several others. The regulations are also anticipated to define "precious metals" as including silver, gold, platinum, and others, as well as waste and scrap containing precious metal or precious-metal compounds, of a kind use principally for the recovery of precious metals.

¹³ IFCA §1245(f).

IFCA §1246: Insurance, Reinsurance & Underwriting Activities

A number of insurance activities are subject to sanctions under IFCA, and while previous sanctions have certainly had some bearing on the marine insurance industry, IFCA represents what may prove, in its effect, to be a rather dramatic expansion of U.S. sanctions as they pertain to marine insurers and underwriters.

IFCA imposes sanctions on persons that “knowingly” provide underwriting, insurance or reinsurance services:¹⁴

- For any Iran-related activity for which sanctions have been imposed under any U.S. law which would include any of the sanctions imposed under CISADA, ITRASHA, IFCA, or any other provision whether implemented by legislative statute, regulation, or Executive Order;
- To or for any person with respect to, or for the benefit of any activity in the energy, shipping or shipbuilding sectors for which sanctions can be imposed under IFCA;
- To or for any person for the sale, supply, or transfer to or from Iran of the precious metals and raw materials for which sanctions can be imposed under IFCA; or
- To or for any person designated for the imposition of sanctions under the International Emergency Economic Powers Act in connection with Iran’s proliferation of weapons of mass destruction or support for international terrorism
- To or for any Iranian person on the SDN list.

On their face, these provisions appear to impose a far greater burden on marine insurers and P&I Clubs to be aware of their insureds’ activities. Nevertheless, as with other sanction programs, there is an exception to the imposition of sanctions for insurers, reinsurers, or underwriters who exercise due diligence in establishing and enforcing “official policies, procedures, and controls” to ensure that the person does not underwrite or enter into a contract to provide insurance or insurance or reinsurance for the proscribed activities.¹⁵ “Due diligence” is not defined and OFAC confirmed in its recent published guidance only that the determination will be made on a case-by-case basis.

It seems apparent however that U.S. authorities will expect marine insurers, reinsurers and underwriters to be proactive in analyzing the activities of their insureds, lest they be held in violation of U.S. sanctions for having insured a sanctionable activity by one of their Members. Certainly, at a minimum any P&I Club confronted by a Member’s inquiry regarding whether a

¹⁴ It bears mentioning that the term “significant” is not used to define the level of underwriting, insurance or reinsurance services that might trigger the imposition of sanctions. Therefore, the provision of such services might lead to the imposition of sanctions regardless of the value of those services if the underlying transaction violates one or more of the various sanctions directed at Iran.

¹⁵ IFCA §1246(d). IFCA also confirms that transactions for the sale of agricultural commodities, food, medicine or medical devices to Iran or for the provision of humanitarian assistance can be insured, reinsured or underwritten and are not subject to sanctions. IFCA §1246(c).

particular shipment or trade violates U.S. sanctions needs to undertake a very careful review to attempt to satisfy its due diligence obligation. Nevertheless, based on prior communications with the State Department (but note that the Treasury Department is charged with implementing IFCA), it is believed that the authorities will take into account practicality in assessing whether a Club's policies and procedures and implementation of same are sufficient.

IFCA §1252: Vessel Reports

While §1252 does not set forth any sanctions, it directs the President to annually provide Congress with a report on the names, owners, and operators of "large or otherwise significant vessels" that have entered Iranian ports controlled by the Tidewater Middle East Company. It is not clear exactly to what purposes these reports will be used. The provision is nonetheless of particular interest for those engaged in maritime transportation for obvious reasons.

IFCA §1253: Potential Penalties Authorized by IFCA

IFCA authorizes the imposition of many of the same types of penalties authorized under other sanction programs. Some of the more significant sanctions that might be imposed include the following:

- (i) denying the foreign person access to the U.S. banking system, which would include the inability to effect any transaction anywhere in the world in U.S. dollars regardless of whether that transaction has anything to do with sanctionable conduct;
- (ii) blocking property of the foreign person that comes within the jurisdiction of the U.S., including U.S. dollar wire transfers;
- (iii) imposing any of the same sanctions on the principal executive officers of the foreign person; and
- (iv) preventing the corporate officers, principals or controlling shareholders of the foreign person from entering the U.S.;

Furthermore, unlike other sanction programs, IFCA provides that the civil and criminal penalties described in the International Emergency Economic Powers Act (IEEPA) shall apply to a person who "violates, attempts to violate, conspires to violate, or causes a violation" of IFCA or any regulations enacted thereunder.¹⁶ Those civil penalties are currently set at the greater of \$250,000 or twice the amount of the prohibited transaction, and the criminal penalties include a fine of \$1 million, or if a natural person, imprisonment of 20 years, or both.¹⁷

¹⁶ See IFCA §1253.

¹⁷ 50 U.S.C. §1705.

Conclusion

The most notable provision of IFAC is §1246 which specifically imposes sanctions on insurers who insure any Iran-related activity for which sanctions have been imposed under any U.S. law. There is a statutory exception for insurers who have exercised due diligence in an effort to avoid providing insurance for prohibited activities. However, given the broad scope of the new provision it is expected that the authorities will expect insurers to be proactive in exercising due diligence.

Unlike prior U.S. sanctions, the sections of IFCA which prohibit the provision of “significant goods or services” to the energy, shipping or shipbuilding sectors or Iran, to a port operator, or to any Iranian party on the U.S. SDN list, do not have any monetary thresholds. Instead, the standard for a violation is “significant.” While there is a definition of “significant” in the Guidance issued by OFAC with respect to IFCA, it seems clear that determinations will be made on a case by case basis. The Guidance also defines the shipping sector of Iran, and that definition is somewhat narrower than it might have been, and appears to be focused on Iran’s own ability to engage in ocean transportation.

Finally, the amendment of Executive Order 13622 is important, as there is now no doubt that transporting petroleum (crude oil), petroleum products or petrochemical products from Iran constitutes a violation of EO 13622.