

# OVERVIEW

There are various sanction regimes applicable against numerous states, entities and individuals. The penalties that are applicable for breach are varied and are draconian in some circumstances.

## US TREASURY DEPARTMENT'S OFFICE OF FOREIGN ASSETS CONTROL (OFAC) ADMINISTERED THE IRANIAN TRANSACTIONS REGULATIONS AND THE IRANIAN ASSETS CONTROL REGULATIONS

These regulations represented a comprehensive suite of sanctions applicable to US persons and others in the jurisdiction of the US.

### 9 JUNE 2010 – UN RESOLUTION 1929

Following three earlier rounds of sanctions, the UN Security Council passed resolution No. 1929 and imposed further UN sanctions on Iranian entities. The resolution was adopted by 12 to two votes: Brazil and Turkey voted against the resolution, and Lebanon abstained. The states represented on the Council were concerned with the lack of co-operation with the International Atomic Energy Agency, Iran's failure to fully suspend its uranium enrichment activities and its pursuit of military nuclear applications.

### 10 JUNE 2010 – UK REGULATIONS AMENDED

Following UN Resolution 1929, the UK enlarged its list of targeted individuals and entities.

### 1 JULY 2010 – US CISADA

President Obama signed the Comprehensive Iran Sanctions, Accountability & Divestment Act (CISADA) on 1 July. It amended and added to existing sanction legislation in respect of Iran but also sought to extend its application extra-territorially to non-US citizens and entities.

### 26 JULY 2010 – EUROPEAN COUNCIL DECISION

This Decision (binding upon member states of the EU) contained a number of wide-ranging measures in a number of trades, financial services, transportation and energy, plus asset-freezing and provisions against nominated individuals, banks, companies and certain entities associated with the Islamic Republic of Iran Shipping Lines (IRISL).

### 26 JULY 2010 – EUROPEAN COUNCIL REGULATION 668/2010

Regulations were issued that further expanded the list of sanctioned individuals and entities to which existing EU sanctions were applicable.

### JULY 2010 – BIMCO CLAUSE

BIMCO issued a new charterparty clause dealing with sanctions imposed whilst a voyage is en route to destination. The clause placed the burden upon charterers to produce alternative voyage orders or to indemnify the owners for the consequences of complying with the initial orders.

### 27 OCTOBER 2010 – EUROPEAN REGULATION 961/2010

EU Regulation 961/2010, which has direct effect, implemented the European Council Decision of 26 July 2010 and added further restrictions in respect of trade with Iran, particularly on dual-use cargos and key equipment for the Iranian oil and gas industries.

# CLUB COVER



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International sanctions in respect of Iran are complex and are in a state of flux. The various worldwide statutory provisions affect key trades, shipping, energy, finance and insurance. "Am I in breach of sanctions by carrying out this voyage with this cargo and do I still have insurance cover?" is the most common question put to the club. Unfortunately, the club is not in a position to provide members with confirmation as to whether they are in breach of sanctions. The club's recommendation is clear and consistent: specific legal advice must be sought in respect of each shipment. The circumstances when club cover automatically ends due to breach of sanctions are narrow. This article explains the position in relation to club cover, but members should also consider their insurance programme as a whole and should discuss their insurance arrangements with their broker.

## AM I IN BREACH?

For each shipment, the following questions must be addressed:

- 1 Know your customer – am I dealing with a designated person/entity?
- 2 Is the voyage to/from Iran?
- 3 Does the cargo fall into those listed as forbidden or in need of licencing by the relevant authorities?
- 4 Does this breach sanctions in:
  - US, UK and/or EU?
  - Flag State?
  - Country of incorporation of owner/manager?
  - Country of loading/transit/transhipment/discharge?

If the answer to any of the above is "yes" or is unclear, then members should seek immediate legal advice from their preferred lawyer. The club cannot confirm to a member whether a particular trade or shipment will breach sanctions. The club can recommend suitable law firms if needed. Members must act diligently and make enquiries to satisfy themselves as to whether their trading activities will put them in breach of any sanctions.

## IMPACT OF BREACH ON CLUB COVER

Does breach of any sanctions automatically end my club cover? No.

The impact on club cover entirely depends on the circumstances and whether the member's actions put the club itself at risk of being found to be in breach. Club cover ends automatically if the club is put in the position of being in breach of sanctions because of the member's conduct. If a member breaches sanctions but that breach does not automatically expose the club, then cover remains, although there may be further issues, as considered further below.

No breach: if a member is not in breach, then clearly club cover continues.

Breach: if a member is in breach (or believes he may be in breach), then it is crucial that an assessment of the risks is made by the member as soon as possible.

**If a breach of sanctions by the member means that penalties may be incurred by the member ALONE – club cover remains in place.** Thus, a member may be in breach of sanctions, but if that fact does not make the club potentially liable for penalties, then club cover continues. However, this does not guarantee that claims will be paid, in full or at all; there are a number of usual exceptions to cover coupled with a number of policy defences. These may mean that club cover may be prejudiced, may become discretionary or may not be available at all.

Member's P&I cover, of course, is designed to respond to member's P&I liabilities. Breach of sanctions may result in fines being addressed to the ship, master, crew or shore personnel, or charges attracting imprisonment for the relevant individuals. These fines and legal costs may not be covered or may be subject to the board's discretion. The member would have to satisfy the board that he took all such steps as appear to the board to be reasonable to avoid the event giving rise to the liability.

Under the rules, no claim is recoverable if it arises out of or is consequent upon the ship blockade-running or being employed in an unlawful trade, or if the board determines that the carriage, trade or voyage was imprudent, unsafe, unduly hazardous or improper. A voyage to Iran may be held to fall within this exclusion, which may result in any subsequent claim being rejected.

Under some sanction regimes, it is forbidden to provide insurance to designated individuals or entities. Given the nature of the subscription insurance and reinsurance market, some insurers may inadvertently find that they may be exposed to sanctionable penalties. Market insurers are increasingly including provisions that absolve them from any liability to pay their proportion of a claim following such sanctionable activity by the assured. To the extent that the club is unable to recover claims from reinsurers due to a member's conduct, then any reimbursement from the club will be similarly reduced. Rule 6.22 (or 6.16 in Standard Offshore Rules) provides that a member will not recover from the club any liabilities that are not recovered by the club under any applicable reinsurance contracts because of a shortfall in recovery from reinsurers due to any sanction, prohibition or adverse action against them by a state or international organisation. Shortfall includes any failure or delay in recovery by the club caused by the reinsurers making payment into blocked accounts.

**If a breach of sanctions by the member means that penalties may be incurred by the member AND by the club – club cover automatically ends at the time of the breach.** Under rule 17.2(5) (see our circular dated 9 July 2010), a member shall cease to be insured by the club in respect of any ship entered by him if the ship is employed by the member in a carriage, trade or on a voyage that will thereby in any way howsoever expose the club to the risk of being or becoming subject to any sanction, prohibition or adverse action in any form whatsoever by any state or international organisation.

Under Standard club cover, the automatic cessation of cover only relates to the ship itself, which is in breach of sanctions; it does not affect club cover of any sister or associated ship, nor any other ship chartered by the member. For cover to automatically end, there must be causative linkage between the member's sanctionable conduct and the strict application (or risk) of sanctions and penalties against the club. An example of a statute that does this is US CISADA. However, other laws in other states may have similar effect. It is for this reason that the above rule (17.2(5)) is not expressed to be limited to breaches of CISADA.

The club does not control nor have knowledge of where members' ships are trading. The club does not dictate to members where they may or may not trade. Therefore, the club does not expressly exclude trade with a particular person or nation. The club does prospectively require members to comply with Flag State and Class requirements. For example, if a member operates his ship in breach of the relevant Flag State law, then club cover ends.

**Breach of sanctions by the club ALONE does not, in of itself, automatically end a member's cover.** Rule 17.2(5) does not contain reciprocal language. However, in practical terms, given the potential penalties available and the subsequent threat to the club, the club takes stringent steps to ensure that it does not breach any sanctions.

#### **PENALTIES**

Authorities have realised that restriction of access to finance and insurance is a very effective tool in limiting the trade of a sanctioned regime or country. Penalties for breach of sanctions vary from one jurisdiction to another and are liable to change at short notice. However, over recent years, there has been a hardening of political will and this has manifested itself as an increasingly severe suite of penalties. For example, under US CISADA, the President must impose three penalties from a list of nine wide-ranging sanctions:

- 1 Denial of US export-import bank loans or credit facilities for US exports
- 2 Denial of licences for the US export of military or military useful technology
- 3 Denial of US bank loans exceeding \$10m per year
- 4 Prohibition on sanctioned person, being a financial institution, serving as primary dealer in US government bonds or as repository for US government funds
- 5 Prohibition on US government procurement contracts
- 6 Prohibitions within the US of foreign exchange transactions
- 7 Prohibitions within the US of banking transactions such as transfers of credits or payments
- 8 Freezing of assets within the US
- 9 Restrictions on imports into the US.

#### **EFFECT OF AUTOMATIC CESSATION**

Automatic cessation means that cover immediately ceases. The relevant ship is then off risk. Club cover will not respond in respect of subsequent P&I liabilities occurring after the moment of cessation, other than liabilities for which the club has given an extant letter of undertaking, or under for example, a Bunker Blue Card. The club will then issue a notice of cancellation in relation to any relevant blue cards. The member's cover remains in place for incidents predating the cessation. The member remains liable for premium up to and including the date of cessation and for overspill calls; he is not liable for premium after the date of cessation. The club can meet a member's liabilities up to the date of cessation in the usual way, but the club will not respond to incidents thereafter.

#### **IMPACT ON OTHER POLICIES AND MORTGAGES**

If a member's conduct causes club cover to cease, it may have a similar effect on their hull and machinery cover (or other policies). Members should carefully examine the wording of such policies with their brokers, as any potential cessation of such covers may not be limited to the ship in question; it may affect the entire insured fleet.

Cancellation of insurance may impact a member's financing arrangements, as it may be classified as an event permitting or triggering foreclosure of any mortgages secured on the ship, or indeed upon the balance of the fleet.

#### **FUTURE RULE CHANGES**

If sanction regimes continue to harden, then the club may need to make further rule changes (in addition to those set out in our circular dated 12 October 2010, to be tabled before a meeting of members in January 2011).

#### **CONCLUSIONS**

The certainty provided by an established insurance and reinsurance programme may be undermined by the application of sanctions. Members are advised to continue to make diligent enquiries to ensure compliance with all applicable sanction regimes.