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US Secondary Sanctions Against Iran: Why Arbitral and Financial Institutions Should Be Cautious

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This post, which follows up on a **recent submission** in respect of the impact of asset freezes on arbitral and financial institutions, addresses some of the issues that may be faced by such institutions as a result of restrictions that form part of the United States' secondary sanctions against Iran. A third and final post will discuss the effects of US secondary sanctions against Russia.

US Secondary Sanctions Currently in Place Against Iran

The US sanctions regime against Iran has a long and complex history: the US has imposed a multitude of restrictions on activities with Iran under various legal authorities since the 1979 seizure of the US Embassy and hostage taking of American diplomats in Tehran. Today, a fragmented and intricate web of both primary and secondary US sanctions against Iran remains in place.

Whereas primary sanctions typically prohibit individuals and entities that are under (or that trade in goods or technology that fall under) the jurisdiction of the sanctioning state from engaging in trade and/or financial transactions with a target, secondary sanctions threaten to impose penalties on foreign individuals and entities that are not under the jurisdiction of the sanctioning state and are involved in transactions that present no nexus to that state, if these foreign individuals and entities maintain commercial and/or financial relations with a target. US secondary sanctions, in particular, are "*designed to force foreign companies to choose between conducting business with the United States and* […] *sanctioned countries.*"[1)]

The Office of Foreign Assets Control ("**OFAC**") of the US Department of the Treasury, which has primary responsibility for implementing US financial sanctions, maintains the "Specially Designated Nationals and Blocked Persons List" (the "**SDN List**") as a key part of its efforts.[2)] The SDN List contains individuals, companies and other entities whose assets are blocked, either as a result of the fact that these individuals and entities are acting for or on behalf of, or are owned or controlled by, a target state, or pursuant to a non-country-specific programme, such as those that target terrorists and narcotics traffickers.

A US person – usually defined as any US citizen or permanent resident alien, any entity organised under US laws (including foreign branches) and any person in the US – is generally prohibited from engaging in transactions involving any person or entity designated as an SDN. In addition,

non-US persons and entities (including foreign financial institutions) risk, under certain sanctions programmes, incurring secondary sanctions for engaging in or facilitating significant transactions involving a person or an entity on the SDN List. This is the case, in particular, under a series of Executive Orders ("**EO**") issued following the Trump Administration's withdrawal from the Joint Comprehensive Plan of Action ("**JCPOA**") in 2018, including **EO 13846 dated 6 August 2018**, **EO 13871 dated 8 May 2019** and **EO 13902 dated 10 January 2020**. These EOs impose significant restrictions on non-US persons and entities, *inter alia* in respect of transfers of funds originating from Iran and/or made by or on behalf of Iranian persons or entities.

Do the Activities of Arbitral Institutions and their Banks Fall Within the Scope of US Secondary Sanctions Against Iran?

EO 13846 primarily targets Iran's energy, shipping and banking sectors. EO 13871, in turn, imposes sanctions in respect of the Iranian iron, steel, aluminium and copper sectors. Finally, EO 13902, issued by President Trump following Iran's strikes against two US military bases in Iraq, focuses on the construction, mining, manufacturing, textiles and financial sectors of the Iranian economy.

All three of these EOs authorise the imposition of blocking sanctions on persons and entities that provide material assistance to identified targets. As a result, it might be arguable that an arbitral institution that administers a dispute involving (and requests the payment of advances on costs from) any such target might expose itself to blocking sanctions in respect of any assets the arbitral institution might hold in the US.

For instance, it could be argued, based on a black-letter interpretation of section 1(a) of EO 13846, that an arbitral institution risks incurring blocking sanctions if it administers a dispute involving *inter alia* the National Iranian Oil Company (NIOC), Naftiran Intertrade Company (NICO), the Central Bank of Iran, any Iranian person or entity included in the SDN List or any other person or entity included in the SDN List whose property and interests in property are blocked pursuant to EO 13846. Similarly, on the basis of a strict interpretation of section 1(a)(iv) of EO 13871 and of section 1(a)(iii) of EO 13902, it may be possible to argue that administering a dispute involving any person whose property and interests in property are blocked pursuant to either one of these EOs (which may include any person that operates in the iron, steel, aluminium or copper sector of Iran, and any person that operates in the construction, mining, manufacturing, textiles or financial sector of the Iranian economy, respectively) falls within the scope of sanctionable activities.

All three EOs also threaten non-US financial institutions with blocking and correspondent account and payable-through account **("CAPTA") sanctions**, which prohibit, or impose strict conditions on, the opening or maintaining by a foreign financial institution of a correspondent account or a payable-through account at any US bank.

For instance, among other measures, EO 13846 provides, in section 2(a)(ii), that CAPTA sanctions may be imposed on any financial institution determined to have knowingly conducted or facilitated any significant financial transaction, *inter alia* on behalf of any Iranian person included in the SDN List or any other person on the SDN List whose property and interests in property are blocked pursuant to EO 13846. Similarly, section 2(a)(iii) of EO 13871 and section 2(a)(ii) of EO 13902 authorise the imposition of CAPTA sanctions on foreign financial institutions that knowingly conduct or facilitate significant financial transactions for or on behalf of any person whose property and interests in property are blocked pursuant to EO 13871 or to EO 13902, respectively.

A “financial transaction” encompasses any transfer of value involving a financial institution, including in particular the receipt or origination of wire transfers on behalf of or involving designated parties.[3)]

Arguably, such proscribed activities include the acceptance by a non-US bank of registration fees and advances on costs paid in the context of arbitration proceedings.

Does the General Authorisation in Respect of Legal Services Apply to Arbitral Institutions and their Banks?

Notwithstanding the restrictions under EOs 13846, 13871 and 13902, the services provided by arbitral and financial institutions in the context of international arbitration proceedings may be deemed to be authorised under US law, if such services are considered to fall within the scope of authorised legal services and payments for legal services, as defined in the **Iranian Transaction and Sanctions Regulations** (“**ITSR**”).

Indeed, the prohibitions set out in the EOs apply except to the extent provided by statutes or in regulations, orders, directives or licenses. Section 560.525(a) *cum* 560.525(d) of the ITSR authorises activities and payments related to the initiation and conduct of legal proceedings, including arbitral proceedings, within or outside the United States.

OFAC has clarified that permissible transactions and activities under this general authorisation include reasonable and customary payments for the provision of legal services, as well as judicial costs and fees.[4)] The authorisation therefore presumably also extends to the payment of registration fees and advances on costs. Note, however, that acceptance of such payments may still be subject to licensing pursuant to section 560.525(d)(1) of the ITSR, and that the activities and transactions in question “*should not involve persons designated on* [the SDN List] *in connection with Iran’s support for international terrorism or proliferation of weapons of mass destruction (WMD) unless exempt or otherwise permitted.*”[5)]

In any event, despite the existence of the above-mentioned general authorisation related to legal services, there is no denying that the potential exposure to secondary sanctions weighs heavily on both banks and arbitral institutions. Financial institutions, in particular, are acutely aware of the proliferation and potential risks of US secondary sanctions, a breach of which could result in a bank being cut off from US correspondent and payable-through accounts or, in certain cases, being designated as an SDN. As conservative market participants, banks therefore often prefer to altogether abstain from conducting or facilitating any transactions with Iranian counterparties, even non-sanctioned parties, and avoid handling any funds that may be linked to Iran.

While arbitral institutions have been keen to publicly state that sanctions merely complicate but do not lethally obstruct the administration of arbitration proceedings, both arbitral institutions and their banks ought to diligently monitor the risk of secondary sanctions in evaluating ongoing and future cases involving Iranian parties.

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References

?1 Lucinda A. Low/William M. McGlone, Avoiding Problems under the Foreign Corrupt Practices Act, US Antiboycott Laws, OFAC Sanctions, Export Controls, and the Economic Espionage Act, *in* Sandstrom/Goldsweig (eds), Negotiating and Structuring International Commercial Transactions, 2nd, 2003, pp. 217-218.

?2 OFAC, *Specially Designated Nationals and Blocked Persons List*, accessible at <https://home.treasury.gov/policy-issues/financial-sanctions/specially-designated-nationals-and-blocked-persons-list-sdn-human-readable-lists>.

?3 See for instance OFAC, *Frequently Asked Questions*, n. 174, accessible at <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/174>.

?4, ?5 OFAC, *Frequently Asked Questions*, n. 856, accessible at <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/856>.

This entry was posted on Thursday, November 11th, 2021 at 8:45 am and is filed under Iran, Sanctions, United States
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