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Lifting of Iran Sanctions: A Time for Cautious Optimism? Background to the Iran Sanctions Legislation

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In international arbitration, the effect of international sanctions regulations usually arises at two key stages. First, at the commencement of arbitration, where arbitral institutions, arbitrators and counsel involved in the proceedings must consider if they are potentially in breach of such regulations. Secondly, at the enforcement stage, if an award is challenged under the New York Convention 1958, on public policy grounds.

A consideration of Iran-related sanctions is timely, given the recently launched Joint Comprehensive Plan of Action (JCPOA) on 15 July 2015 announcing the gradual lifting of nuclear-related international sanctions in exchange for the dismantling of Iran's nuclear weapons program. UN Security Council Resolution 2231 of (20 July 2015) automatically lifts UN Sanctions on the Iran Nuclear Program (under Resolutions 1737, 1747, 1803, and 1929) on the day that Iran is certified as fulfilling all its commitments under the JCPOA ("Implementation Day")) ("secondary sanctions").

EU Regulations targeting Iran's nuclear program will also be lifted on Implementation Day. The Office of Foreign Assets Control (OFAC) confirmed that the US government will publish guidelines eagerly awaited by international businesses preparing to gain access to nearly $60 billion in hard currency that is currently frozen, as well as anticipated trade in crude oil and petroleum derivatives which Iran had previously used to finance its nuclear program.[1)]

The effect of sanctions in international arbitration

Three observations can be made which suggest that the Iranian sanctions continue to have a significant effect on international arbitration.

First, although the developments herald significant relaxations in the US and EU related measures targeting Iran's nuclear sanctions under the JCPOA, terrorism or human rights related ("primary") Iran sanctions remain untouched. Accordingly, people or entities sanctioned for human rights abuses or terrorism, will still need to be monitored as part of a normal compliance program in any business. To elaborate further, Regulation 267/2012 was intended to inhibit Iran's ability to develop nuclear weapons, and includes prohibitions similar to Regulation 359/2011 on "directly or indirectly" making "funds" or "economic resources" available to the entities designated in its appendices, as well as a blanket prohibition on investment in the oil and gas industry, and restriction on services such as insurance and banking. It is likely to be lifted on Implementation

Day by the JCPOA. Regulation 359/2011 is not affected by the JCPOA and consists of an asset freeze directed at parties involved in violations of human rights in Iran. It is a breach of Regulation 359/2011 to provide "funds" or "economic resources" both "directly and indirectly" to entities mentioned in the lists of "designated persons" annexed to Regulation 359/2011.

Secondly, the actual lifting of the EU and US sanctions is itself subject to other factors. The most important is confirmation by the International Atomic Energy Agency (IAEA) that Iran is indeed taking steps to dismantle its nuclear weapons. Additionally, the "P5 + 1" countries (France, Germany, UK, Russia, US and China) as well as Iran itself, must obtain approval for the JCPOA from their respective national legislative bodies. Such process may involve a range of domestic reactions, from mere rubber-stamping to reopening a national debate.

Thirdly, the proposed relaxations are non-retroactive. The JCPOA envisages a long, slow process of about 10 years in order to be fully implemented. This means that the current Iran sanctions regime will be lifted in phases, with a "snap-back" mechanism to re-implement and enforce previously lifted sanctions if the IAEA finds that Iran has not honoured its commitments.

The current regime

Compliance with the Iran sanctions regime involves examination of regulations from at least three main legal sources.

Resolution 1737 of 26 December 2006, (as modified by Resolutions 1747, 1803 and 1929) contains the primary content of the current Iranian nuclear sanctions legislation.

The measures include the imposition of travel bans and the freezing of assets of certain persons involved in nuclear proliferation and ballistic missile-related activities. They also list items, materials, equipment, goods, and technology which cannot be supplied to Iran.

In the USA, a series of Executive Orders and sanctions-related legislation governs the regime. In particular section 1244(c) of the Iran Freedom and Counter-proliferation Act (IFCA) prohibits the provision of "significant financial, material, technological or other support, to, or goods or services in support of … an Iranian on the SDN list". This SDN list is a list of "Specially Designated Nationals" maintained by OFAC and regularly updated.[2)]

In the EU, the legislation is implemented through Regulations 267/2012 (nuclear weapons program) and 359/2011 (human rights). Each EU member state must implement measures which are "effective, proportionate and dissuasive" for the breach of EU law. EU Regulations prohibit both the direct and indirect making available of funds (defined as "financial assets and benefits of every kind") or economic resources ("assets of every kind whether tangible or intangible, movable or immovable, which are not funds but may be used to obtain funds, goods or services") to "designated persons".

Although a European lex loci arbitri is commonly specified in arbitration clauses involving Iranian interests, US sanctions remain highly relevant, through the application of the above US secondary sanctions regime, which has extra-territorial effect.

Sanctions compliance at the commencement of arbitration proceedings

A certain amount of due diligence must be regularly undertaken by arbitral institutions

administering cases, or arbitrators and counsel who are EU nationals, to ensure that designated persons do not receive funds or economic resources as a result of the arbitration process.

There is no clear definition of "significant" under section 1244(c) of the IFCA. One of the most frequent queries on the OFAC website is exactly this. That being said, an arbitration award with a monetary value is potentially of "significance" to an Iranian person on the SDN list. Clearly this definition cannot be read out of context. In 2014, the Islamic Republic of Iran won its first ever investor-state arbitration against Turkcell. It would be difficult to argue that an award resulting in the provision of funds to the Islamic Republic could indirectly benefit terrorist groups and other entities on the SDN list. Nonetheless, a number of practical and legal problems are triggered by the potential presence of a SDN designated person in arbitration.

First, it becomes pertinent to consider whether the dispute is even arbitrable. The answer depends to a large extent on the law of the seat of arbitration. Italian and Swiss courts, for example, have arrived at opposing conclusions as to the issue of arbitrability.

Secondly, there are practical issues raised by the transfer of resources. Domestic legislation in many EU member states requires either authorisations or licenses from the appropriate national authorities in order to make or receive fund transfers involving sanctioned persons or States. Generally, transfers for EUR 10,000 or more regarding payment to satisfy claims are authorized on a case by case basis by the relevant authorities.

It is not impossible to obtain the necessary authorisations. However, the process itself poses enormous practical problems for the litigants. Some service providers such as banks and law firms prefer to take a conservative approach and avoid these issues entirely, when balancing the estimated transactional fees against the inconvenience of making such applications.

Sanctions compliance at the enforcement stage

Typically, the same complaints of a breach of international sanctions that were raised during the commencement of arbitration resurface when an award issued in favor of a party subject to sanctions is challenged under the public policy exception (in the New York Convention of 1958) at the enforcement stage. There are also instances where an entity becomes subject to sanctions only after the issuance of an arbitral award in its favor.

As with the challenge at the commencement of arbitration, the chances of success of such an argument depend greatly on judicial support in the country where this complaint is heard. Given its past attitude in similar circumstances, in the well-known case of *Fincantieri Navali Italiani Spa and Oto Melara Spa v. Ministry of Defence, Armament and Supply Directorate of Iraq*, Republic of Iraq, XXI YBCA 594 (1996) , it was perhaps not surprising that in 2014, the Swiss Supreme Court did not hesitate to enforce the arbitral award of the Iranian Arbitration Institution in respect of a claim of a Iranian company against a Swiss company with Israeli shareholders. This was despite objections that payment of the award attracted criminal liability for the Israeli shareholders under the laws of Israel.[3)]

By way of background, in *Fincantieri*, several Italian suppliers had entered into contracts for supply of military technology for the Iraqi Navy just before Iraq's invasion of Kuwait. When the UN Security Council declared an arms embargo, the underlying contract became illegal and could not be performed. Despite the contractual provisions for arbitration in Paris, the Italian companies

commenced court proceedings in Italy against Iraq, seeking termination of the contract and damages. The Court of Appeal in Genoa held that due to the embargo legislation, the parties could not freely dispose of the contractual rights in issue, hence the issue was not arbitrable and Italian courts have jurisdiction to determine the suit. The Swiss Supreme Court however came to the opposite conclusion on similar facts, regarding a dispute involving Fincantieri and its agents for the sales to Iraq. The Swiss court held that, the only condition for arbitrability of disputes according to Swiss law was that it be a dispute in relation to property, and thus arbitration proceedings could continue.

A continuing duty of due diligence for sanctions compliance?

Whilst the proposed relaxation of the (secondary) sanctions may facilitate doing business in Iran, including for the arbitration community, there is a continuing duty of due diligence which cannot practically be ignored. Iran sanctions have been some of the oldest and far-reaching sanctions in place in the Middle East and therefore a crucial contributing factor to sanctions-related case law. It must be noted that there are also US, UN and EU sanctions existing targeting human rights infringements in (inter alia) Libya, Syria, Egypt, and Tunisia, which potentially affect the conduct of international arbitration in a similar manner as the current Iran sanctions. Thus, despite relaxations anticipated by the JCPOA, there is continual pressure for arbitral institutions, counsel, and arbitrators to maintain adequate due diligence efforts in respect of sanctions compliance.

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References

?1 Kenneth Katzman, *Iran Sanctions*, Congressional Research Services, available here.

?2 The term “designated persons” is used under the EU regulations and “SDN list” is maintained by OFAC. Whilst these are of course different lists, there is significant overlap and for the purposes of this discussion, the term is used interchangeably.

?3 See Leo Szolnoki, *Swiss Court Rejects Award Challenge over Iran Sanctions*, 6 March 2014 (Global Arbitration Review).

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