

Sanctions and export controls: ignorance is not bliss

Written by WilmerHale

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Over recent months, international sanctions and export controls have featured heavily in the news; the recent escalation of tension in the Korean peninsula, the ongoing conflict in Syria and Iran's continued attempts to develop nuclear weapons are all examples of international situations where sanctions or trade controls are in force. Even though these are examples that attract headlines, there are multiple pitfalls in other less high-profile countries and industries in which an unaware company can slip up and which can result in serious implications for the company and the individuals involved. It therefore seems like a sensible time to provide an introduction to those unfamiliar with the area as well as identify key areas of potential concern for those in an in-house/compliance role.

At the risk of being overly simplistic, sanctions and embargoes are political trade restrictions put in place against target countries with the aim of maintaining or restoring international peace and security. Sanctions commonly take the form of:

- financial sanctions on government officials or former officials and their families, government bodies and associated companies and terrorist groups and individuals associated with those groups;
- embargoes on exporting or supplying arms and associated technical assistance, training and financing;
- a ban on exporting equipment that might be used for internal repression; and
- bans on imports of raw materials or goods, such as oil, from the sanctions target.

In addition, export controls are aimed at categories of goods and are a vital tool of the British government in performing the function of ensuring that UK citizens who are involved in the trade of controlled goods are fit and proper people to do so, as well as to gather intelligence so the UK authorities are aware of what controlled goods other countries are buying.

This article is solely focused on the UK aspects of sanctions and export controls, but companies should be aware of the extremely long reach of the US authorities and legislation, under which severe penalties can be imposed if jurisdiction can be obtained.

Export controls

By way of background, the trade in strategic goods and technology is governed by the Export

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Control Act (ECA) 2002 and various regulations made under it. The most important of these is the Export Control Order 2008 (the 2008 Order) but it should be noted there are a number of additional territory-specific orders that are made under the ECA 2002 which are also currently in force.

The goods and technology which the legislation covers are detailed in a document titled the Military List¹ but for the purposes of this article we assume that companies involved in the trade of military hardware are familiar with the relevant provisions of the legislation. Of more concern for non-defence industry businesses is that a number of commercial goods with potential uses in industry also have the potential to be used for military purposes or terrorism. Examples are components from the aviation or telecommunications industries; certain chemicals; information security products like encryption software; and radioactive materials. These items are commonly known as 'dual use' items.

It is these items that require particular care and attention. The legislation applies to the export of dual use goods from the UK or, if going directly or indirectly to a specific prohibited destination, then the transfer of dual use software or technology by electronic means.

The important thing to note about UK export control legislation is that it applies equally to persons carrying out activities in the UK and to the activities of UK persons, wherever in the world they may be. A UK person is a UK national or a body incorporated under the law of any part of the UK. A UK national is defined, *inter alia*, as an individual who is a British citizen, whether or not they also hold another nationality and irrespective of where they reside.

Once it has been determined that the legislation bites on an individual or company and the type of goods, then any intended transaction can only lawfully take place under the authority of a valid UK licence. Licences are obtained from the Export Control Organisation (ECO), but this can be a time-consuming and complicated process which, in our experience, can take weeks and in some cases months. This can be damaging to a business when a client wants to obtain the goods urgently. Sometimes additional delays are incurred because 'end-user' undertakings need to be obtained, confirming the ultimate destination of the goods.

Breach of the export control legislation is a criminal offence which usually takes one of two forms. Most of the export control prosecutions in relation to dual use goods have proceeded with an offence under the Customs and Excise Management Act 1979, which makes it an offence for a person to export goods in circumstances where the export is restricted or

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prohibited regardless of a company's ignorance of the relevant export control. If found guilty, the maximum fine is up to three times the retail value of the goods or £1,000, whichever is the greater. There is also the more serious offence of deliberate evasion of the export control legislation, which can lead to a term of imprisonment of up to ten years.

In addition to any sentence imposed by a court and the reputational damage that a conviction can attract, the other often overlooked issue is that, following a successful prosecution, the government could seek to obtain a confiscation order for the benefit of the criminal conduct. This is a complicated area but, depending on the value of the goods, could be a significant amount of money and be financially very damaging for a company.

As would be expected, some countries have stricter controls if they are embargoed destinations. These countries change but at present include Armenia, Azerbaijan, Belarus, Burma, Democratic Republic of Congo, North Korea, Eritrea, Iran, Lebanon, Ivory Coast, Lebanon, Libya, Syria, Sudan and Zimbabwe. Extreme caution should be taken in relation to trade in controlled or dual use goods with these countries. By way of an example, Christopher Tappin, a UK business man, was extradited to the US to face charges of supplying batteries for surface-to-air missiles to Iran. In November 2012 Mr Tappin pleaded guilty and received a 33-month jail sentence.

The message is clear in relation to exporters or traders of dual use goods; if there is any doubt at all about the status of an item then the company must contact the ECO and confirm whether or not a licence is needed. Ignorance of the relevant control is not a defence and, as can be seen above, lack of compliance could have serious implications on both the business and individuals.

Sanctions

While export controls are very broad in the way they are targeted, sanctions are intended to be more focused, whether that be on specific countries or specific individuals. Sanctions are imposed at individual state level following a UN Security Council resolution and, as appropriate, EU regulations. In the UK, sanctions are then generally applied by way of secondary legislation, such as statutory instruments.

In the UK, HM Treasury is responsible for the implementation and administration of international financial sanctions that are in effect. The relevant statutory instruments apply to any person in the UK and to any person elsewhere who is a British citizen or is a body incorporated or

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constituted under the law of any part of the UK including banks, financial institutions, charitable organisations and non-governmental organisations. The UK statutory instruments do not apply to subsidiaries operating wholly outside the UK and which do not have legal personality under UK law.

Once sanctions have been imposed on a designated person, then their funds and property are frozen and may not be dealt with in any way unless a licence has been obtained from HM Treasury. If an individual makes any funds, economic resources or, in some circumstances, financial (or related) services available directly or indirectly to or for the benefit of persons listed under the relevant statutory instrument or EC regulation, then they would be guilty of a criminal offence which carries a potential maximum prison sentence of seven years.

Following the Arab Spring, both the UN and EU imposed wide-ranging sanctions on both former government officials and their families and connected businesses and financial institutions. Similar restrictive measures have been imposed on Iranian institutions in order to apply pressure on the Islamic Republic of Iran to end nuclear proliferation and the development of nuclear weapon delivery systems. In broad terms, these restrictive measures are incredibly onerous as the asset freeze applies to all assets including family trust funds and UK subsidiaries. On an individual level the sanctions can be damaging as it is suddenly not possible to pay bills, manage stock portfolios or pay mortgages. On a corporate level these measures can be crippling.

From a designated company's point of view, a significant area of concern in relation to restrictive measures is the lack of specific evidence that the Council of the European Union have when applying the measures. A recent European Court judgment² criticised the Council and held that the fact that the bank was part-owned by the Iranian state was not of itself a ground for designation, and could not justify the imposition of restrictive measures as support for an allegation that the bank provided support for Iranian nuclear proliferation. In addition, the Court said the Council's reasons were 'excessively vague'. Similar criticism has been made in relation to the evidence produced against individuals.

A perhaps more relevant issue relates to companies which hold or deal in funds or other economic resources for a designated person or company. If that is the case, then it is essential that a company does not deal, use, alter, move, allow access to or transfer the funds unless a licence is obtained from HM Treasury. The restrictions also apply to brokers and portfolio management. The only exception to this is that funds, such as interest payments, may be credited to a designated person or company.

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In practical terms, a company that holds or deals in funds belonging to a designated person or company should work with the designated person and their professional advisers to draft licences for submission and approval from HM Treasury. This is particularly important when the funds may also belong to a non-designated person, for example where there is a trust of which a designated person is one beneficiary but the other beneficiaries are not the subject of the restrictive measures. In situations like this, tension can arise between the trustees and the non-designated beneficiaries, and this is where working together to obtain the appropriate licences is a sensible and pragmatic course of action.

In conclusion

Both export control and sanctions are a potential minefield for British companies and institutions. This minefield is present both in relation to risk exposure on behalf of the company, but also in terms of client relationships. Clients tend not to like the delays required to obtain the appropriate licences, whether they be for the sale of dual use controlled items or, for example, if assets are frozen and the freeze is resulting in investment positions losing value because they cannot be actively managed. It is therefore essential to manage clients' expectations and have in place processes which allow making any licence application as quick a process as possible. Unfortunately, companies have no control over the actual provision of licences and both the ECO and HM Treasury can take a long time to issue or approve licences, but again this is an area where active expectation management is vital.

It is also important that companies stay up to date in relation to both export controls and sanctions. A breach of either type of legislation and the implications tend to be disastrous for both the business and the individuals involved. Ignorance is not a defence.

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NOTES

1. Schedule 1 to the Export of Goods, Transfer of Technology and Provision of Technical Assistance (Control) Order 2003 which should be cross-referenced with the Department for Business, Innovation & Skills document titled 'The UK Military List of Items That Require Export Authorisation'.

2. *Bank Saderat Iran v Council*.

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Case T-494/10 *Bank Saderat Iran v Council* (5 February 2013)