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U.S. Raises Bar for Sanctions Compliance in Maritime, Energy, and Metals Sectors

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On 14 May 2020, the U.S. Department of the Treasury, the U.S. Department of State, and the U.S. Coast Guard jointly issued a "Sanctions Advisory to the Maritime Industry, Energy and Metals Sector, and Related Communities" (Advisory) that significantly raises the level of due diligence U.S. authorities expect from the industry to counter illicit shipping practices designed to evade sanctions. The Advisory builds upon past advisories issued by the Office of Foreign Assets Control (OFAC)[1] by providing additional guidance on the most common deceptive practices and by outlining risk-mitigation measures to be adopted by all industry participants, including: ship owners, managers, operators, brokers, ship chandlers, flag registries, port operators, shipping companies, freight forwarders, classification service providers, commodity traders, insurance companies, and financial institutions.

OFAC and the State Department have long focused on shipping to enforce sanctions policy because, as noted by Deputy Assistant Secretary of State (DAS) David Peyman, shipping is "the key artery to evade sanctions." Increasingly, since 2008 when OFAC designated the Islamic Republic of Iran Shipping Lines (IRISL) and 18 affiliated entities on the Specially Designated Nationals and Blocked Persons List (SDN List), OFAC and the State Department have targeted numerous shipping and commodity interests, especially those engaged in trade involving entities connected to Iran, North Korea, Syria, and Venezuela. As discussed below, the Advisory urges the entire maritime industry, particularly those involved in the supply chains for the energy and metals sectors (e.g., crude oil, refined petroleum, petrochemicals, steel, iron, aluminum, copper, sand, and coal) to adopt risk-mitigation measures designed to detect deceptive shipping practices and avoid being a party to transactions and activities that are prohibited or sanctionable under U.S. law.

Deceptive Shipping Practices

The Advisory highlights and provides guidance on the following categories of deceptive shipping practices, which are commonly employed to evade economic sanctions.

- **Disabling or Manipulating the Automatic Identification System (AIS) on Vessels:** Those vessels engaged in illicit activities often intentionally disable their AIS transponders or

manipulate the data transmitted in order to mask their movement or identity. This practice, sometimes referred to as “spoofing,” is used to conceal a vessel’s next port of call or to broadcast a different name, International Maritime Organization (IMO) number, Maritime Mobile Service Identity, or other identifying information.

- **Physically Altering Vessel Identification:** Vessels involved in illicit activities sometimes paint over vessel names and IMO numbers to obscure their identities and pass themselves off as different vessels.

- **Falsifying Cargo and Vessel Documents:** Sanctions evaders frequently falsify shipping documentation pertaining to petrochemicals, petroleum, petroleum products, metals (steel, iron), or sand in order to disguise their origin. Falsifying certain documents (including customs and export control documents) is illegal in most countries, and irregularities may provide a basis to hold a shipment until its contents are validated.

- **Ship-to-Ship (STS) Transfers:** Although STS transfers are usually conducted for legitimate purposes, STS transfers conducted at night and in areas of known illicit activity are frequently undertaken by bad actors to evade sanctions, by concealing the origin or destination of surreptitiously transferred petroleum, coal, and other material.

- **Voyage Irregularities:** In order to disguise a cargo’s origin, ultimate destination, or recipient, it is common for sanction evaders to use indirect routing, unscheduled detours, or the transit or transshipment of cargo through third countries. Although transit and transshipment are common in global shipping, routes and destinations that deviate from normal business practices are red flags for illicit activity.

- **False Flags and Flag Hopping:** Vessels engaged in sanctions evasion may falsify their flag to conceal their illicit trade. They may also repeatedly register with new flag states “flag hopping” to avoid detection.

- **Complex Ownership or Management:** Those engaged in sanctions evasion exploit the complex business structures that underlie the shipping industry to conceal the ultimate beneficial owners of vessels and cargos, using shell companies or multiple levels of ownership. Bad actors also may engage in a pattern of frequent changes in the ownership or designated manager under the International Safety Management Code.

Risk-Mitigation Measures

In order to detect and counter deceptive shipping practices, like those listed above, U.S. authorities expect companies to implement risk-mitigation measures. Specific recommendations are made for different categories of the private sector in Annex A of the Advisory. Generally, however, the Advisory makes clear that companies are expected to expand their compliance programs and to adopt business practices, like those described below, to address red flags and anomalies that indicate illicit or sanctionable behavior.

- **Institutionalize Sanctions Compliance Programs:** The Advisory recommends that companies assess their sanctions risk and implement compliance and due diligence programs. This should include written, standardized operational compliance policies, procedures, standards of conduct, and safeguards, to be updated regularly and reinforced

with personnel training. In addition to risk-specific measures discussed below, company policies should protect personnel who disclose illicit behavior. It is also important to communicate to counterparts an expectation that they (and their affiliates) take appropriate steps to operate in compliance with applicable economic sanctions, including having appropriate controls in place (e.g., monitor AIS, cargo screening, authenticate bills of lading, etc.).

- **Establish AIS Best Practices and Contractual Requirements:** Entities in the maritime industry, based on their individual risk assessments, should research and institute measures to monitor a vessel's AIS history to identify potential past and present manipulation. Flag registries, insurers, financial institutions, and others in the maritime industry, are encouraged to promote continuous broadcasting of AIS by vessels, throughout the life of a transaction, especially in high-risk trade areas. Any signs and reports of AIS transponder manipulation should be investigated before entering into new contracts involving problematic vessels, and service providers should amend contracts to provide for termination where vessels are found to have been disabling or manipulating AIS for illegitimate reasons or where cargos are transferred to client vessels that are manipulating or not broadcasting AIS.

- **Monitor Ships Throughout the Entire Transaction Lifecycle:** Ship owners, managers, and charterers should, based on their risk assessment, institute procedures to monitor vessels. This could entail supplementing AIS with Long Range Identification and Tracking (LRIT) and receiving periodic LRIT signals on a frequency informed by the entity's risk assessment. Ship owners and managers should institute measures to scrutinize vessel STS transfers, verifying the other vessel's name, IMO number, and flag, and checking that it is currently broadcasting accurate AIS or LRIT data. In addition, companies should be on the lookout for frequent changes in vessel ownership between companies controlled by the same beneficial owner, particularly where there is no discernable legitimate purpose for the transfer.

- **Know Your Customer and Counterparty:** Flag registry administrations, insurers, financial institutions, managers, and charterers should institute measures to conduct risk-based due diligence as appropriate. This due diligence might include maintaining the names, passport ID numbers, address(es), phone number(s), email address(es), and copies of photo identification of each customer's beneficial owner(s).

- **Exercise Supply Chain Due Diligence:** Exporters and other entities across the maritime supply chain should institute due diligence procedures as necessary to ensure that recipients and counterparties to a transaction are not sending or receiving commodities that may trigger sanctions (e.g., Iranian petroleum and North Korea-origin coal). This could include controls that allow for verification-of-origin and recipient checks for ships that conduct STS transfers, particularly in high-risk areas. As necessary, companies should consider requesting copies of export licenses (where applicable) and complete, accurate shipping documentation, including bills of lading that identify the origin or destination of cargo. As appropriate, private sector maritime entities are also encouraged to review the details of the underlying voyage, including the vessel, cargo, origin, destination, and parties to the transaction. In particular, and in line with their internal risk assessment, parties are encouraged to review the relevant documents in order to demonstrate that the underlying goods were delivered to the port listed in the documentation and not diverted in an illicit or sanctions-evading scheme.

- **Contractual Language:** Companies should incorporate best practices, like those outlined in the Advisory, into contracts related to their commercial trade, financial, and other business

relationships in the maritime industry.

- **Industry Information Sharing:** The Advisory recommends that information related to deceptive shipping practices be shared broadly, across industry groups, financial institutions, flag administrations, the IMO, classification societies, and relevant government authorities.

As noted above, Annex A to the Advisory provides more specific guidance to particular segments of the maritime industry, including marine insurers; flag and port state administrations; industry associations; commodity traders, suppliers, and brokers; financial institutions; ship owners, operators, and charters; classification societies; vessel masters; and crewing companies. In addition, Annex B to the Advisory contains information on U.S. sanctions law, specifically relevant to the maritime industry.

In preparing the Advisory, U.S. authorities consulted with and received feedback from affected maritime supply chain actors. This resulted in modifications to earlier drafts of the Advisory, which demonstrates that, by proactively raising concerns with U.S. authorities, industry can influence how sanctions are developed and enforced. Despite such positive developments, the risk-mitigation measures recommended in the Advisory raise issues for many in the global shipping industry, not simply because of their cost, but because some measures may be deemed incompatible with the structure and nature of maritime shipping transactions.

Notwithstanding such practical concerns, the message from U.S. authorities is clear that companies in the maritime, energy, and metals sectors must invest more in due diligence and take proactive measures to avoid being caught in potential sanctions breaches. Vessel owners, for example, cannot simply disclaim responsibility for the deceptive practices of their charterers or vessel managers, or rely on their status as non-U.S. persons. To the contrary, if a vessel is found to have evaded sanctions through deceptive practices or engaged in voyages that are subject to secondary sanctions, the vessel may be subject to detention or seizure in the United States. Moreover, any companies or individuals involved could face sanctions or civil or criminal penalties, if they fail to meet the higher standard of care outlined in the Advisory and take appropriate action.

Conclusion

The Advisory issued last week, along with recent industry outreach and public statements by the State Department, indicate risk-mitigation measures, like those outlined in the Advisory, are more than recommended best practices. Going forward, in the context of an enforcement action, adequate due diligence measures will be expected. DAS Peyman, who heads the State Department’s Office of Economic Sanctions Policy and Implementation, has acknowledged that “it is costly to invest in due diligence” and sometimes “business leaders don’t see value added.” However, while speaking recently to reporters in London, Peyman issued a stark warning to such business leaders: “they will see value added when there are hard costs to bear including their business potentially going out of business because of a designation or enforcement action.”

There is every reason to believe that U.S. authorities will move forward with enforcement actions consistent with these statements. Since the beginning of 2019, dozens of non-U.S. vessels, owners, and operators have been designated on the SDN List due either to their role in the evasion of sanctions or their dealings with SDNs, sometimes unwittingly. Such crippling sanctions have been visited upon companies ranging from small European vessel owners to shipping behemoths like COSCO Shipping Tanker (Dalian).

As U.S. sanctions policy evolves, K&L Gates works with U.S. authorities on behalf of our clients to help develop practical solutions. We are trusted advisors in all segments of the maritime, energy, and commodities sectors, providing sanctions counsel, developing tailored compliance programs, and representing companies in all areas of enforcement. If you have any questions about the Advisory and what it means for compliance with U.S. sanctions, please let us know.

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[1] https://www.treasury.gov/about/organizational-structure/offices/pages/office-of-foreign-assets-control.aspx

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