CLIFFORD CHANCE

Client briefing
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Financial sanctions affecting Libya – *Further Update*

As detailed in our March 2011 briefing (available here), since February, the United Nations, the United States and the European Union have all imposed sanctions on the Libyan government and select Libyan companies, which to date have reportedly resulted in the freezing of Libyan state assets estimated at $120 billion.

In this briefing, we consider recent developments in relation to the sanctions affecting Libya, against a backdrop of ongoing military operations for which no immediate end is in sight.

UN Sanctions

UN Security Council Resolution 1970 (2011), of 27 February 2011, first imposed sanctions in relation to Libya, including restrictions on the export to Libya of certain goods that could be used for military purposes or internal repression, and an asset freeze on Muammar Qadhafi and 5 members of his immediate family.

Those sanctions were extended on 17 March 2011 by Security Council Resolution 1973 (2011) which, as well as giving effect to the "no-fly zone" established at that time, amended the language of the asset freeze (see further below) and designated a number of additional entities as sanctions targets, including the Central Bank of Libya, the Libyan Investment Authority (LIA) and the Libyan National Oil Corporation (NOC).

EU Sanctions

In the EU, Council Regulation (EU) No. 204/2011 of 3 March 2011 (the "**EU Regulation**") gave effect to the sanctions imposed by the UN in February across all Member States. At that time, as well as designating the individuals listed as sanctions targets by the UN, the EU designated a number of additional individuals and regime officials as sanctions targets.

Pursuant to Article 5 of the EU Regulation:

1. All funds and economic resources belonging to, owned, held or controlled by designated individuals or entities are to be frozen;

2. No funds or economic resources may be made available, directly or indirectly, to or for the benefit of the designated individuals or entities; and

3. Participation in activities that will directly or indirectly circumvent these restrictive measures is prohibited.

The EU Regulation was amended a number of times throughout March and April, including to give effect to UN Security Council Regulation 1973 (2011), each time designating further entities as sanctions targets, including a number of state-owned banks and other entities.

On 12 April 2011, by Council Implementing Regulation No. 360/2011, the EU designated a number of additional entities, including some (but not all) of the subsidiaries of the previously listed entities, LIA and NOC. Among those listed

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were certain joint venture entities in Libya that NOC had formed with non-Libyan oil companies.

The broad provisions of the EU Regulation, interpreted against the backdrop of the expansive wording of the UNSC Resolution, have caused difficulties for those seeking to comply with its terms, despite the fact that they reflect a standard formula employed in EU sanctions programmes. The provisions of Article 5, including restrictions against freezing funds or economic resources owned *"or controlled*" by a designated person, and the prohibition against making funds or economic resources available "*indirectly*" to "*or for the benefit of*" a designated person, have raised questions as to who it is safe to do business with, given that the persons designated by the EU include various Libyan sovereign wealth funds, the NOC and other state-owned oil companies, which have extensive assets around the world including subsidiaries that have not been expressly designated.

Recognising this uncertainty in the market, the EU has sought to clarify the position, by the inclusion of a new Article 6a in the EU Regulation with effect from 26 March 2011 (implemented by Council Regulation (EU) No. 296/2011), as follows:

> *"With regard to persons, entities and bodies not designated ..., in which a person, entity or body designated ... has a stake, the obligation to freeze the funds and economic resources of the designated person, entity or body shall not prevent such non- designated persons, entities or bodies from continuing to conduct legitimate business in so far as this business does not involve making available any funds or economic resources to a designated person, entity or body."*

While Article 6a makes it clear that the prohibitions in the EU Regulation do not automatically apply to the funds and economic resources of non-listed entities that are owned or controlled by a designated person (simply by virtue of that ownership stake), the same would not be true if there were grounds to conclude or suspect that transacting with such an entity would result in funds or economic resources being made indirectly available to a designated person.

It therefore remains unclear as to how much due diligence is required for an EU person to satisfy itself that a transaction with a non-designated subsidiary would not involve making funds or economic resources available, directly or indirectly, to its designated parent. The EU has previously issued guidance that the funds and economic resources of a non-designated entity having separate legal personality from a designated person or entity are not covered by the freeze unless those assets are controlled or held by the designated entity[1]. In light of this, and because Article 6a was in our view clearly enacted to clarify that in the normal course, it is safe to transact with non-designated subsidiaries, we consider it likely that when contemplating dealing with a subsidiary, there would need to be some specific evidence available to suggest that funds or other economic resources would thereby flow to a designated target, before the prohibitions are engaged. Such evidence might include that assets are to be channelled direct to the designated parent, or that the subsidiary is acting as an agent of the parent. Of course, in light of the designation of numerous entities, particular vigilance will be expected. Each case should therefore be considered on its individual merits and where appropriate, guidance could be sought from the authorities in the relevant Member State.

UK Sanctions

The Libya (Asset-Freezing) Regulations 2011 (the "**Regulations**"), passed on 3 March 2011 provide for the enforcement of the EU Regulation (as amended) in the UK.

As noted in our previous briefing, however, on 27 February 2011, the UK Government passed the Libya (Financial Sanctions) Order 2011 (the "**Order**"), which pre-dates the EU Regulation and which was intended to give effect to UN Security Resolution 1970 (2011) in the UK directly (i.e., before the EU had yet acted). While the Order was later amended by the Regulations to the effect that it no longer applies to any transaction or other act prohibited by the EU Regulation, the extent to which it may still apply to certain transactions is unclear, given that the language of the Order is apparently broader than that of the EU Regulation in certain respects.

Specifically, while the asset freezing requirement in the EU Regulation applies to funds and economic resources belonging to, owned, held or controlled by designated persons, the equivalent provision in the Order (which mirrors the language in UN Security Council Resolution 1970 (2011)), extends to "*dealing with*" funds, other financial assets or economic resources that are owned or controlled, directly or indirectly, by any individual or entity acting on behalf of, or at the direction of a designated person, or any entity owned or controlled by a designated person. For the purposes of the Order, "*designated persons*" include those listed by the UN Security Council, which therefore includes those entities designated on 17 March 2011, including the LIA and the NOC.

When the Order was first published, HM Treasury indicated in guidance that the financial sector and other persons should bear in mind that Muammar Qadhafi and his family have considerable control over the Libyan state and its

[1] See for example, the "*EU Best Practices for the effective implementation of restrictive measures*" issued by the Council of the EU in 2008, available here.

enterprises in deciding how to conduct proper due diligence over any transactions involving Libyan state assets. This guidance, which was reiterated on 11 March 2011, indicates that for the purposes of compliance with the Order, unless a licence applies, UK persons and entities cannot assume that a transaction may proceed just because a Libyan counterparty has not been listed specifically as a sanction target. As mentioned in our previous briefing, following on from similar action in the US (see below), HM Treasury has granted a General Licence that permits dealings with financial institutions incorporated outside of Libya that may be owned or controlled by the Libyan government, and has issued a number of specific licences in other cases.

Rather unhelpfully, when the EU Regulation was amended to include Article 6a, HM Treasury remained silent as to whether similar clarification also applies to the potentially broader language of the Order. In addition, we note that while the Order was originally enacted to give effect to UN Security Council Resolution 1970 (2011), the language of that Resolution has since been amended (by Resolution 1973/2011), to reflect that that the asset freeze only applies to entities specifically designated by the Security Council as sanctions targets. As the Order has not yet been amended to reflect these developments, there remains an apparent inconsistency, although it may be appropriate to interpret the provisions of the Order in line with the amendments contained in Security Council Resolution 1973. Notwithstanding this, the extent to which transactions with non-listed subsidiaries of a designated person are permitted under the terms of the Order remains an area on which additional guidance from Whitehall would be welcome.

US Sanctions

The sanctions imposed by the US in Executive Order 13566 of 25 February 2011, are much broader than those imposed in Europe. The US sanctions, administered by OFAC, impose a block on all property or interests in property of the Government of Libya, including its agencies, instrumentalities, controlled entities and the Central Bank of Libya, whether expressly designated by OFAC or otherwise. In addition, the US sanctions impose a block on all property and interests of certain other persons and entities expressly designated by OFAC, including senior officials of the Government of Libya and members of the Qadhafi family. The sanctions apply to all property or interests in property in the US or in the possession or control of US persons and preclude non-US persons from executing transactions for targets of the sanctions through US banks or the US financial system.

On the same day, OFAC issued a general license (which is on broadly equivalent terms to the HMT General Licence issued on 3 March and referred to above) permitting transactions with banks owned or controlled by the Government of Libya that are organised under the laws of a country other than Libya, so long as the transaction does not otherwise involve the Government of Libya or a person whose assets are blocked by the sanctions, as well as a further general license allowing the normal operation of an investment fund in which a blocked person has a non-controlling minority interest. In addition, on 26 April 2011, OFAC also issued a general license authorizing transactions involving Qatar Petroleum or the Vitol group of companies related to oil, gas, or petroleum products exported from Libya under the auspices of the Transitional National Council of Libya, provided that neither the Government of Libya nor any other blocked person, with the exception of Arab Gulf Oil Company, receives any benefit from the transaction.

Conclusion

The uncertainty created by the different wording and scope of the various sanctions regimes has caused practical problems for multinationals seeking to ensure compliance by their global operations. Perhaps some comfort can be taken, however, from the fact that, on both sides of the Atlantic, there are provisions in the legislation that apply a safe harbour from liability for entities acting in good faith pursuant to the relevant regulations, and that relevant authorities have to date been willing to offer guidance in specific cases (although this can take time to receive) and appear to be working together in relation to the authorisation of licence applications where appropriate.

For further information or advice on issues arising in relation to the Libyan sanctions regime, please do not hesitate to contact a member of our team.