Lloyd's Market Association Guidance Note for use of the LMA Transit Fee Condition

Context

The situation in the Strait of Hormuz (the Strait) is fluid, and members will be aware of suggestions by Iran (and other states) that they will be charging for safe transit of the Strait (whether by direct payment or other forms of consideration). Whilst the LMA Sanctions Clauses remain robust and entirely valid, the LMA believes the position taken by OFAC on required due diligence in respect of tolls is something for which underwriters may need an extra response. To that end, the LMA Legal Committee has produced the attached clause to assist the hull and war markets in demonstrating that extra care has been taken by underwriters.

This clause has been drafted for use with hull policies. Issues arising out of cargo insurance will differ due to the inherent difficulties in identifying which vessel a cargo is being carried on. This note uses "toll" to mean any kind of payment or consideration (whether financial or otherwise) for transiting the Strait.

The note has been drafted on the basis of consultation with Jawdat Khurshid KC, the LMA LegCom, LMA Financial Crime Workstream and Lloyd's. Also thanks to Hogan Lovells Cadwalader for their assistance with the table of current sanctions and terrorism legislation.

Issues addressed:

1. Protecting underwriters' position in the event of the following:

    a. A vessel pays a toll to transit the Strait and seeks reimbursement from underwriters;

    b. A vessel pays a toll, is not seeking reimbursement but underwriters and owners are aware of the payment in advance;

    c. A vessel pays a toll, but underwriters are not aware at the time that they offer coverage;

    d. A vessel pays a toll – owners did not intend to make the payment at inception but are obliged to do so after inception when they try to transit the strait.

2. The clause has been drafted in the same style as the LMA 3200 sanctions clause (although the remedy here is termination of cover, rather than suspension, as terrorist legislation may be implicated). Thus, it attempts to be law and jurisdiction agnostic in

terms of its effectiveness. It defines what should not happen and the remedy in the event that there is a breach.

3. The Transit Fee Condition is intended to work in tandem with either the LMA 3100A or LMA 3200 sanctions clauses and is not a substitute. The sanctions clause will continue to be effective to suspend coverage in the event that any action of the insured exposes the insurer to sanctions risk. The sanctions clause may operate earlier than the Transit Fee Condition, because of the “exposure” language in the sanctions clause. Irrespective of whether the sanctions clause has operated to suspend cover, however, in the event of any failure to comply with the requirements of the Transit Fee Condition, coverage for vessel(s) in respect of which any transit fee, toll or charge, or other consideration is paid or given shall be terminated, and (re)insurers shall be irrevocably discharged, from the moment of payment or giving, as provided for in paragraph 2 of the Condition.

4. Working in tandem with an appropriate sanctions clause, the Transit Fee Condition operates to do the following:
   a. It demonstrates to the relevant regulator that the underwriter has taken all possible steps in terms of the increased due diligence expected to identify whether their insured has paid a transit fee, a toll or other consideration;
   b. It flags to the insured that underwriters will not be able to participate in insuring any transit where a toll has been paid and demonstrates to the regulators that underwriters are taking care to avoid being part of the facilitation of any payment or other consideration to an entity which might be considered by regulators to be a terrorist organisation.
   c. It explicitly confirms that insurers will not reimburse the insured for any toll paid or other consideration. The legal advice that we have taken is clear that this would be illegal. The clause has been deliberately drafted widely in terms of who the toll is paid to or other consideration in order that underwriters do not have to get involved with demonstrating that an entity is linked to the IRGC, and it will also exclude payments to a non-Iranian entity such as Oman, or other States, reflecting the fact that payments for transiting an international waterway are illegal under UNCLOS;

d. It confirms that coverage will be cancelled at the time the vessel pays a toll or other consideration. This is because (although a fact and jurisdiction specific analysis will have to be carried out on each transaction) the legal advice we have received is that there is a risk that an underwriter insuring a vessel that has made a payment to an Iranian government linked entity will be considered to have facilitated terrorism and breached US and EU sanctions if applicable. The UK, US and EU have historically taken different approaches to designating the Iranian government as a terrorist organisation. However, at this point, following very recent UK legislation, all three have now proscribed the IRGC. The US has also sanctioned the Iranian Persian Gulf Strait Authority (PGSA). It is also important to note that risk of UK terrorism financing offences does not solely arise through dealing with proscribed entities and dealing with any entities where there is knowledge of or reasonable grounds to suspect terrorism financing, is an offence.

5. Attached to this note is a table showing the current sanctions and financial crime position of the US, the UK and the EU with respect to Iranian entities. This position changes and it can be seen that they are not consistent. The US also has sanctions in place which do not permit a US insurer, and those subject to US jurisdiction, to provide any services to a party in Iranian territorial waters which some US legal practitioners consider extends to the provision of insurance cover for a vessel.

6. A copy of the recent OFAC FAQ 1249 and Alert relating to payment of tolls is attached to this note which underwriters should consider carefully. The OFAC FAQ and Alert highlights the risk of US Secondary Sanctions exposure for underwriters irrespective of whether they are a US insurer under Executive Order 13902.

7. The Transit Fee Condition cancels coverage with respect to the particular vessel concerned. We have submitted the clause to OFAC and OFSI so that they are aware that coverage will not be cancelled for a whole insured fleet by reason of an owner's or manager's actions with respect to a single vessel needing to transit the Strait with the toll payment or other consideration.

8. It is OFAC's current position that if an owner pays a toll or other consideration, the insurance cover for the relevant vessel should cease from that point onwards. We do

not know OFAC’s position as to when insurance of the relevant vessel can resume, if at all.

Caveat

This note is likely to be subject to change as the sanctions and financial crime position alters rapidly and underwriters should take their own legal advice to protect their position. As always, advice will need to be specific based upon the location of the underwriter and the parties to the contract.

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