



New US extraterritorial sanctions against Iran

On July 1 President Obama signed into law new US economic sanctions against Iran. As we anticipated in our April 2010 briefing, these sanctions target non-US companies active in Iran's upstream and downstream petroleum sectors. The legislation also mandates broad new compliance obligations for US banks and their non-US subsidiaries and for companies that contract with the US government.

Introduction

Since 1995, the United States has had a broad trade and financial embargo in place against Iran, prohibiting virtually all trade and investment activities with Iran by US persons or any other person within the United States. In recent years these economic sanctions have also been enforced against non-US companies when the US government finds that there was sufficient contact with the United States.

In recent weeks both the United States and EU have moved to impose far-reaching new economic sanctions on Iran, building on the significant expansion of UN sanctions on Iran adopted by the UN Security Council in June. On July 1, 2010 President Barack Obama signed into law legislation broadening a range of US sanctions against Iran, titled the Comprehensive Iran Sanctions, Accountability and Divestment Act of 2010 (CISADA). CISADA gave President Obama expanded authority, and Congress is now putting political pressure on him, to impose severe penalties on non-US companies involved in Iran's energy sector and on non-US financial institutions engaging in certain disfavored activities.

Many of the key provisions of CISADA are fundamentally unchanged from the draft legislation that we discussed in our April 2010 briefing¹. Among the basically unchanged provisions are the authorization of US state and local

governments to divest their assets from entities that invest in, or facilitate investment in, Iran's energy sector.

CISADA also contains a number of new provisions added late in the legislative process. It requires the US government to issue regulations imposing broad new compliance obligations for US banks and, in a significant expansion of the extraterritorial application of US sanctions, for their non-US subsidiaries as well. CISADA also mandates regulations imposing compliance requirements on companies that engage in US government procurement and other US government contracting.

With respect to the EU, on July 26 the European Council agreed that the EU would go far beyond the UN resolution in imposing new sanctions on Iran, including broad restrictions on transactions and financings involving Iran's oil and gas sector. For further information, please refer to our briefing [EU Council introduces new economic sanctions against Iran](#).

Cutting off non-US financial institutions from the US financial system

"In the end, the act presents foreign banks doing business with blacklisted Iranian entities a very stark choice: Cease your activities or be denied critical access to America's financial system" – Senator Chris Dodd, June 24, 2010.

New regulations that will be issued under CISADA will impose broad new compliance obligations on financial

¹ The briefing is available at www.freshfields.com/publications/pdfs/2010/Apr10/27944.pdf.

institutions that provide correspondent banking services from the United States. The regulations will prohibit, or impose strict conditions on, the opening or maintaining of a correspondent account for any foreign financial institution found by the US government to have engaged in certain specified activities involving Iran. It will likely take several months for these regulations to be issued.

In this way, non-US banks may be cut off from the US financial system if they engage in the following activities:

- facilitating the Iranian government's efforts to acquire or develop weapons of mass destruction or support terrorism;
- facilitating the activities of persons subject to financial sanctions under any Iran sanctions resolution of the UN Security Council;
- engaging in money laundering or facilitating transactions by Iranian financial institutions related to the activities described in the previous two points; and
- providing significant financial services to the Iranian Revolutionary Guard Corps (IRGC), any of its agents and affiliates blocked under US economic sanctions, or certain blocked Iranian financial institutions.

Regulations will also be issued to require financial institutions that provide correspondent banking services from the United States for foreign financial institutions to do one or more of the following things: (a) perform an audit to ensure that the foreign financial institutions are not engaging in any of the four restricted activities described above; (b) report to the Department of the Treasury any findings of prohibited activities; (c) certify, to the best of their knowledge, that the foreign financial institutions are not knowingly engaging in such activity; and (d) establish due diligence policies, procedures and controls reasonably designed to detect such activity. Violation of the regulations, once they have been issued, could give rise to the severe civil and criminal penalties available for violations of the US Bank Secrecy Act.

US sanctions requirements for non-US subsidiaries of US banks

“US companies have long been banned from doing business with Iran. Now ... foreign entities owned or

controlled by US banks will also be prohibited from doing business with the IRGC [or] the US parent companies will be subjected to severe penalties” – Senator Chris Dodd, June 24, 2010.

Regulations will be issued under CISADA prohibiting any person owned or controlled by a US financial institution from knowingly dealing with the IRGC or any of its agents or affiliates blocked under US economic sanctions. These regulations will likely be controversial with US trading partners². Civil and criminal penalties would be available for the parent US financial institution if it “knew or should have known” that its subsidiary violated, attempted or conspired to violate, or caused a violation of such regulations, once they are issued.

US government contracting

“[CISADA] imposes a US Government procurement ban on foreign companies doing energy business in Iran or helping the Iranian Government to monitor and jam communications among its people. No longer will US taxpayers' money be used to support Iran's corporate sponsors” – Senator Chris Dodd, June 24, 2010.

Under regulations to be issued later this year under CISADA, any person that contracts with the US government will be required to certify that it does not engage in activities for which sanctions may be imposed under the Iran Sanctions Act (these are set out below). A false certification could result in debarment or suspension of the contractor from eligibility for US government contracts for up to three years.

The certification will likely be required for essentially all US government procurement and other US government contracting. It is unclear whether it will cover the subsidiaries of contractors. Congress indicated that contractors should be required to certify for themselves and for all entities they own or control, but the final version of CISADA does not appear to cover subsidiaries in this way.

² The EU and other countries have strenuously objected to previous US laws seeking to require non-US subsidiaries of US companies to comply with provisions of US economic sanctions law.

Separately, CISADA generally prohibits US government agencies from entering into or renewing any contract, after September 29, 2010 (90 days after the enactment of CISADA), with any person or entity that exports certain sensitive telecommunications items to Iran. The sensitive items are any “hardware, software, telecommunications equipment, or any other technology” that is to be used specifically “to restrict the free flow of unbiased information in Iran” or “to disrupt, monitor, or otherwise restrict speech of the people of Iran.”

Broadening the Iran Sanctions Act

As anticipated in our April briefing, CISADA greatly broadens the Iran Sanctions Act of 1996 (ISA). Although the ISA has never before been enforced, it now broadly targets non-US companies that invest in or export goods or services that contribute to the development of Iran’s upstream or downstream petrochemical sector.

Sanctions may be imposed under the amended ISA on persons, whether or not they have any ties or links to the United States, that have knowingly carried out (meaning they have “actual knowledge, or should have known” that they carried out)³ any of the following disfavored activities:

- investing \$20m or more over a 12-month period in the development of Iranian petroleum resources⁴ (which, according to Congress, could include selling or purchasing goods, services or technology), if the investment involves contractual responsibility for such development, or an equity interest in or participation in profits from such development, and directly and significantly contributes to Iran’s ability to develop its petroleum resources;
- exporting goods, services or technology to Iran knowing they would contribute to Iran’s ability to acquire or develop chemical, nuclear or biological weapons or advanced conventional weapons;

³ The definition of “knowledge” in the original ISA was generally limited to “actual knowledge.” CISADA broadens the concept of knowledge in the ISA also to cover situations in which a person “should have known” that they have carried out any of the disfavored activities. It remains to be seen whether the US government interprets the phrase “should have known” as a conscious avoidance standard or as a broader standard of knowledge.

⁴ “Development” includes exploration, extraction, refining and transportation by pipeline. “Petroleum resources” includes oil, natural gas, refined petroleum products and liquefied natural gas (LNG), tankers for oil or LNG, and products related to oil and LNG pipelines.

- selling, leasing or providing to Iran goods, services, technology, information or support with a value of \$1m, or \$5m over a 12-month period, that could directly and significantly facilitate the maintenance or expansion of Iran’s domestic production of refined petroleum products; and
- exporting or providing to Iran (i) refined petroleum products⁵ or (ii) goods, services, technology, information or support, including insurance, finance or shipping services, that could enhance Iran’s ability to import refined petroleum products, with a value of \$1m, or \$5m over a 12-month period. There is a narrow exemption for insurers and reinsurers that the President determines have carried out sufficient due diligence to avoid insuring or reinsuring such export transactions.

The US State Department has indicated to Congress that it has been progressing with reviews of a number of companies that, according to public reports or intelligence sources, have previously engaged in disfavored activities in Iran. It appears the Obama Administration does intend to begin imposing ISA penalties on non-US companies if and when a formal US government investigation finds that such penalties would be appropriate.

Available sanctions under the ISA

The expanded ISA now seeks to require the President to impose at least three types of sanctions from a list of nine sanctions on any person he determines has engaged in any of the disfavored activities set out above. The first three sanctions are new additions to the ISA⁶:

- prohibition of transactions in foreign exchange;
- prohibition of transfers of credit or payments by, through or to any financial institution subject to US jurisdiction that involve any interest of the sanctioned person;

⁵ “Refined petroleum products” is defined to mean diesel, gasoline, jet fuel (both naphtha-type and kerosene-type) and aviation gasoline.

⁶ The draft legislation separately passed in both houses of Congress would have required the automatic imposition of these three new sanctions on persons who had engaged in certain disfavored activities. The final legislation merely adds the three new sanctions to the list of sanctions available to the President.

- prohibition of the acquisition, transfer, import, export or other use of any property subject to US jurisdiction with respect to which the sanctioned person has any interest;
- denial of assistance from the US Export-Import Bank;
- denial of licenses to export from the United States;
- denial of loans or credits from any US financial institution exceeding \$10m in one year;
- for financial institutions, denial of Federal Reserve primary dealer status or denial of US government funds repository status;
- denial of participation in federal contracting; and
- denial of the ability to import goods and services into the United States.

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Limited Presidential flexibility in implementing CISADA

The President retains the ability to waive the application of most of the ISA sanctions under various circumstances. However, to exercise some of the waiver authorities, he now must make a demanding set of findings and reports to Congress. For example, if the President provides the required reports and certifications to Congress, he may waive sanctions in a specific case if the targeted person (a) is based in a country that cooperates in multilateral Iran sanctions efforts or (b) has “taken significant steps toward stopping” its activities involving Iran and has provided “reliable assurances” it will not knowingly engage in sanctionable activities in future.