

International Trade Alert

Enactment of Comprehensive Iran Sanctions Act Expands Extraterritorial Reach of the U.S. Embargo on Iran

June 29, 2010

OVERVIEW

On June 24, 2010, the U.S. House and Senate voted to approve the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010—providing for a substantial expansion of established extraterritorial U.S. sanctions against Iran—by overwhelming majorities of 408-8 and 99-0, respectively. President Obama is expected to sign the bill into law shortly. The legislation follows recent approval of the new UN sanctions against Iran under UN Security Council Resolution 1929 Iran sanctions on June 9, 2010, but provides far more severe unilateral U.S. strictures with significant international reach, particularly in the energy and financial services sectors. The legislation includes provisions for U.S. enforcement against foreign-owned or -controlled affiliates of U.S. financial institutions and includes new certification requirements and other provisions that provide potential trip wires for extraterritorial enforcement and prosecution.

Key provisions include measures to—

- *Energy Sector*: prohibit transactions (including financing, insurance and transportation services) for the supply of refined petroleum products to Iran or for development of Iran’s domestic refining capabilities, in addition to other established extraterritorial prohibitions on new investments in Iran’s energy sector
- *Financial Services*: prohibit U.S. financial institutions from providing correspondent accounts or engaging in other transactions with foreign financial institutions that participate in transactions with specially designated Iranian banks or other designated parties contrary to other prohibitions of U.S. sanctions law; impose certain audit and certification requirements on U.S. institutions; and provide for penalties against foreign-owned or -controlled affiliates of U.S. entities
- *Government Procurement*: require a new certification by U.S. government contractors that they and any entity they own or control (including foreign subsidiaries) do not engage in Iran-related activities that are prohibited by U.S. sanctions. The Act also imposes a ban on contractors that provide “sensitive” Internet or communications technology to Iran that is used to suppress free flow of information or freedom of speech in the country
- *Nuclear Export Licensing*: bar U.S. authorizations for the export or re-transfer of nuclear materials, equipment or technology to countries that have a nuclear cooperation agreement with the United States with jurisdiction over a party that violates U.S. sanctions against transfers of goods or technology to enhance Iran’s nuclear or other proliferation-related capabilities
- *Diversion Risk Destinations*: provide for the designation and imposition of heightened U.S. export control restrictions on countries determined to be a “Destination of Diversion Concern” based on a finding that they present a heightened risk for diversion of sensitive goods and technology to Iran



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- *State Divestment Sanctions*: authorize and provide general standards allowing state and local governments to enact and enforce sanctions laws providing for divestment of public funds from companies with investment activities in Iran's energy sector, validating many state sanctions laws already previously enacted against Iran.

The strong vote of approval for this legislation reflects the growing concerns of members of Congress regarding the unchecked development of Iran's nuclear program and Iran's continued association with sponsorship of U.S.-designated international terrorist organizations, suppression of political dissent and human rights and perceived belligerence in the face of international efforts to pursue a constructive process of multilateral engagement. Just as significant, the vote reflects congressional frustration at the persistent unwillingness of successive presidential administrations to forcefully investigate, apply the sanctions and punish non-U.S. companies for violations of established extraterritorial U.S. sanctions against new investments in Iran's energy sector under the Iran Sanctions Act (ISA) ever since the law was first enacted—originally as the Iran and Libya Sanctions Act of 1996. Accordingly, the new legislation underscores the compulsory requirement for conduct of investigations under the ISA, narrows the president's general waiver authority while providing a basis for targeted waiver of sanctions against individual companies from "closely cooperating countries" and elevates standards of certification necessary to support limited waivers. At this time, these measures are still open to interpretation, and it remains to be seen how they will be implemented and ultimately enforced by the Obama administration.

This international trade client alert provides an initial review of key provisions of the new legislation and some of the potential implications for U.S. and non-U.S. companies.

KEY PROVISIONS

1. Energy Sector Sanctions

The Act renews existing extraterritorial ISA sanctions against new investments of \$20 million or more in a 12-month period in Iran's oil and gas sector and expands the law's provisions to also target Iran's dependence on imported gasoline and other refined petroleum products. The Act provides for imposition of punitive sanctions against any party (U.S. or non-U.S.) that supplies or supports the supply of refined petroleum products to Iran or facilitates development of Iran's domestic refining capacity. The new provisions pertaining to refined petroleum products are slated to take effect one year after the date of enactment. In addition, the Act clarifies and effectively expands the scope of parties that may be subject to punitive action for ISA violations.

The Act requires imposition of punitive sanctions against parties that—

- *Development of Iranian petroleum resources*: invest \$20 million or more in Iran's energy sector or make a combination of investments in a 12-month period of \$5 million each if they reach a combined total of \$20 million
- *Exportation of refined petroleum products to Iran*: engage knowingly in sale or provision of (1) refined petroleum products valued at \$1 million or more, or with an aggregate value of \$5 million or more in a 12-month period, or (2) goods, services, technology, information or support that facilitate Iran's ability to import refined products, including providing underwriting or insurance; financing or brokering; or shipping services
- *Support for Iran's domestic refined petroleum production or importation capabilities*: engage knowingly in sale, lease or provision of goods, services, technology, information or support valued at \$1 million or more, or with an aggregate value of \$5 million or more in a 12-month period, that facilitate the maintenance or expansion of Iran's refined petroleum production capability or Iran's ability to import refined petroleum products
- *Insurance, reinsurance underwriters services, financing and transportation for prohibited activities*: provide (1) insurance, reinsurance, and underwriters services; (2) financing and brokering services; and (3) shipping services, per the express terms of the prohibitions against the provision of goods, services, technology, information or support to Iran in the energy sector. A limited exception is provided for underwriters and insurance providers that engage in due diligence against prohibited involvement that indicates no basis for knowledge that a provision of services is associated with prohibited transactions.

Affected Parties. The ISA provisions generally apply to U.S. as well as non-U.S. parties. The Act increases the ISA's reach to include (1) successors in interest to an entity that engaged in a prohibited activity; (2) persons that own or control the entity that engaged in such activity if they knew or had reason to know the violation occurred; and (3) entities owned or controlled by, or under common ownership with, the sanctionable entity that knowingly engaged in prohibited conduct. Significantly, these provisions provide for the potential imposition of ISA sanctions on companies affiliated with a sanctionable entity even if they are not subject to the ownership or control of that entity.

Penalties. Where a party is found in violation of these provisions, the Act calls for the imposition of three or more of the following potential penalties—

1. prohibition of export-import bank assistance in connection with the export of any goods or services to any sanctioned entity
2. prohibition of the issuance of export licenses to the sanctioned party
3. prohibition of loans from U.S. financial institutions totaling more than \$10 million in any 12-month period to the sanctioned party
4. bar against an affected financial institution from acting as a primary dealer in U.S. government debt instruments or as a repository of government funds
5. prohibition from U.S. procurement or otherwise contracting with the U.S. government, or
6. other measures to restrict imports associated with a sanctioned party.

In addition, the Act adds three new potential penalties to this menu of options:

7. prohibition of any transaction in foreign exchange by the sanctioned party
8. prohibition of transfers of credit or payments between, by, or through financial institutions that involve interests of a sanctioned party
9. prohibition of transfers of property in which the sanctioned party has an interest.

Presidential Waiver Authority. The Act amends the ISA with provisions for a more limited waiver authority than under prior law.

- **General Waiver.** The Act substitutes a new requirement for presidential certification that a waiver is “necessary to the national interest” for the previous certification requirement that such action is “important to the national interest.” The change is intended to set a higher threshold requirement for certification. Such waivers may be issued for up to 12 months, subject to subsequent renewal for periods of six months
- **Cooperating Country Waiver.** Separately, the Act provides the president with authority to issue a limited waiver of sanctions against a specific party, on a case-by-case basis, based on certification that the country of primary jurisdiction over that party is closely cooperating in multilateral efforts to prevent Iran from enhancing its proliferation-related capabilities and based on a finding that the waiver is “vital to the national security interests” of the United States. Such waivers can be issued for up to 12 months and are subject to potential 12-month renewals.

Reporting on Global Trade and Energy Sector Investments in Iran. The Act imposes reporting requirements on the executive branch to facilitate congressional review and monitoring of implementation of the ISA that reflect previous congressional concerns with nonenforcement of the law. These include—

- **Report on Global Trade with Iran.** The Act requires an annual report to Congress regarding trade between Iran and G-20 member countries.

- *Report on Investments in the Iranian Energy Sector.* The Act also requires the executive branch to provide Congress with a report, within 90 days of enactment, on investments in Iran's energy sector from January 1, 2006, through 60 days before the date of enactment. The report is required to provide estimates of the volume of energy supplies imported to Iran, identify significant known energy partners and joint ventures associated with Iran and facilitate other specified information.

2. Financial Services Sector Sanctions

In addition to the extraterritorial restrictions on financial services included in the energy sector provisions of the Act, the legislation requires the U.S. Department of the Treasury to develop implementing regulations designed to target and cut off international financial services with a U.S. nexus that involve proliferation-related activities or support for terrorist organizations by the government of Iran, specially designated Iranian banks or other specially designated Iranian parties, the Iranian Revolutionary Guard Corps (IRGC) or related money laundering activities. These provisions, as well as related audit and certification requirements imposed on U.S. financial institutions that pertain to their foreign-owned or -controlled affiliates, provide a potential basis for extraterritorial enforcement against non-U.S. parties by means of U.S. criminal statutes recognized under U.S. mutual legal assistance treaties (MLATs) with other countries.

Limits on Correspondent Accounts of Non-U.S. Financial Institutions. The Act calls for implementing regulations within 90 days to prohibit or impose strict conditions on correspondent accounts in the United States of non-U.S. financial institutions that (1) facilitate activities of the government of Iran in developing weapons associated with U.S. proliferation concerns or supporting terrorist organizations; (2) facilitate activities of a person subject to UN sanctions restrictions; (3) engage in money laundering activities associated with one of the above activities; (4) facilitate such actions of another bank; or (5) facilitate a significant transaction associated with the IRGC.

Penalties on Foreign Subsidiaries of U.S. Financial Institutions. The Act establishes a prohibition against transactions with the IRGC by foreign-owned or -controlled affiliates of a U.S. financial institution, subjecting those entities to potential U.S. penalties. In addition to liability stemming from violations of existing ISA sanctions or the newly enacted prohibition on provision of refined petroleum products, U.S. parent institutions are made expressly subject to penalties under the Iran Transaction Regulations (ITR) administered by the U.S. Treasury Department's Office of Foreign Assets Control (OFAC) if they have knowledge or reason to know that any entity that they own or control engages in such transactions.

Auditing and Certification Requirements for U.S. Institutions Maintaining Accounts for Non-U.S. Institutions. The Act imposes new requirements on U.S. financial institutions that maintain foreign accounts to (1) perform audits of such accounts for violations of the Act's provisions; (2) report transactions or financial services involving any specially designated Iranian banks, other prohibited parties or other prohibited activities; (3) establish diligence measures to detect prohibited activities; and (4) certify, to the best of its knowledge, that the foreign financial institution is not knowingly engaged in any violation of U.S. sanctions restrictions.

3. Government Procurement Restrictions and Certification Requirements

The Act includes provisions for amendment of the Federal Acquisition Regulations (FAR) barring U.S. government agencies from entering into contracts with persons who engage in sanctionable activities under the legislation. In addition, it provides an express certification requirement that must extend to the contractor's foreign-owned or -controlled affiliates and provides a potential basis for debarment and civil and criminal enforcement action under the False Claims Act for false certifications.

Certification: The Act requires prospective government contractors to certify that they and other entities that they own or control do not engage in any activity that would violate U.S. sanctions on Iran.

Waiver Authority: The Act includes provisions for a presidential waiver of this certification requirement, on a case-by-case basis, based on a written certification that such action is in the U.S. national interest.

Ban on Providers of "Sensitive" Internet or Communications Technology to Iran: The Act bars U.S. agencies from contracting with a party that provides technology to Iran that is used to restrict the free flow of information or free speech in the country.

4. Mandatory Nuclear Export Control Sanctions

Expanding upon preexisting ISA sanctions against individuals who contribute to Iran's nuclear, chemical or biological weapons capabilities or contribute to disruptive levels of conventional weapons procurement, the Act mandates denial of U.S. authorizations for export of nuclear energy sector goods or technology to a country with primary jurisdiction over a person that engages in such activities. While limited waiver authority is available, these provisions provide a basis to disqualify countries that have concluded "123" nuclear cooperation agreements with the United States from U.S. licensing to support peaceful nuclear energy projects in the affected country or in other countries in which persons or companies from such countries have a role.

Ban on U.S. Authorizations: The Act provides that no U.S. license may be issued for export, and no approval may be given, for transfer or retransfer of nuclear materials, components, facilities or other goods, services or technology subject to a U.S. nuclear cooperation agreement to a country with primary jurisdiction over a person subject to sanctions for activities on or after enactment of the legislation that contribute to Iran's nuclear, chemical or biological weapons capabilities or that contribute to disruptive levels of conventional weapons procurement by Iran.

Waiver Authority: The president can waive this punitive ban if he notifies Congress that (1) the government of the country affected did not know or have reason to know of the activity or (2) that the country is taking all reasonable steps both to prevent a recurrence and to penalize the sanctioned person.

Alternative Case-Specific Authorizations: In addition, the president has authority to approve authorizations for affected nuclear exports on a case-by-case basis by making a determination that such action is vital to the national interest and issuing a report to Congress providing justification for the determination.

5. Diversion Risk Destinations

Taking up an initiative originally proposed by the Department of Commerce Bureau of Industry and Security (BIS) a number of years ago, but never implemented, the Act requires the director of national intelligence to identify and prepare a list of countries determined to pose a high risk for diversion of sensitive goods, services, or technology that—

- originate in the United States or are otherwise subject to "dual use" export controls under the Export Administration Regulations (EAR) or controls on U.S. Munitions List items under the International Traffic in Arms Regulations (ITAR)
- would materially contribute to Iran's nuclear proliferation efforts, ballistic missile capabilities or support of international terrorism, or
- are prohibited for export to Iran under UN Security Council resolutions.

Designation of Destinations of Diversion Concern: Based on the list developed by the director of national intelligence, the president must designate countries found to allow substantial diversion of goods, services or technology to Iran as "Destinations of Diversion Concern" and report these findings to Congress. Criteria for designation include—

- the volume of diverted items, technology and services
- the unwillingness or inability of the country to control diversion activities
- the unwillingness or inability of the country to cooperate with the United States in interdiction efforts.

Export Licensing Restrictions: Countries subject to this designation will be subject to a presumption of denial for export licensing of exports or reexports of items and technology that are subject to export control based on nuclear proliferation-related considerations. Increased export licensing requirements could also apply to other controlled items.

Delay in Implementation of Heightened Export Licensing Restrictions: The president may delay imposition of these restrictions for a renewable 12-month period based on determinations that (1) the country is taking steps to institute an export control framework, prevent diversion and comply with and enforce UN resolutions against Iran and (2) government-to-

government cooperation is appropriate to strengthen the country's export control system, as well as by submitting a report to Congress on steps the country is taking to improve its diversion prevention safeguards. The Act provides that government-to-government cooperation includes—

- cooperation between counterpart agencies in information sharing, enforcement, development or strengthening of the country's export controls, or otherwise
- training of the country's export enforcement officials to strengthen diversion prevention
- encouragement of the country to participate in the Proliferation Security Initiative.

Termination of Designation: The president retains authority to terminate a designation by providing certification to Congress that the country has adequately strengthened its export control systems to prevent the diversion of goods, services and technologies to Iranian end-users or Iranian intermediaries.

Congressional Reporting Requirement: The Act also requires the president to submit a report to Congress one year following enactment of the legislation identifying countries that allow diversion of U.S.-controlled goods or technology to countries of concern other than Iran that are: (1) seeking to obtain weapons of mass destruction or ballistic missile capabilities or (2) providing support for terrorist organizations or activities. These provisions further call for the report to discuss the potential advisability of expanding the Destination of Concern framework in reference to such other countries of concern.

6. Authorization of State and Local Government Divestment Sanctions

The Act includes provisions permitting and validating various established U.S. state and local government laws that mandate divestment of public funds from companies that engage in business activities associated with Iran's energy sector contrary to ISA standards. Specifically, it authorizes measures compelling divestment and barring investments of state and local government assets (e.g., state and local government pension funds, etc.) in any entity with investments of \$20 million or more in Iran's energy sector. Significantly, these provisions do not provide a basis to validate divestment measures against companies engaging in other kinds of business activities involving Iran.

7. Other Provisions

Codification of Certain Established OFAC Sanctions: The Act codifies certain U.S. sanctions restrictions against Iran found in the ITR administered by OFAC. These include provisions regarding ITR prohibitions against importation of Iranian goods to the United States (eliminating a prior exception allowing importation of certain Iranian luxury goods) and the core ITR prohibition on exports of U.S.-controlled goods to Iran (with limited exceptions for Internet communications and technology; informational materials; food, medicine and other humanitarian goods; and allowances for licensing exports of aircraft spare parts and components based on aviation safety considerations), as well as provisions for freezing the funds and other assets of specially designated Iranian persons.

Designation and Blocking of Persons Responsible for Human Rights Abuses in Iran: The Act requires identification and development of a list of Iranian government officials responsible for, or complicit in, the commission of human rights abuses in Iran. These provisions mandate imposition of a ban on travel, blocking of property and property interests and prohibition on financial transactions associated with such individuals.

CONCLUSIONS

The Comprehensive Iran Sanctions Act of 2010 significantly expands the extraterritorial reach of established U.S. sanctions against Iran, including substantial enlargement of U.S. measures targeting Iran's energy sector and the availability of international financial services to specially designated Iranian banks, the IRGC and other designated parties. Moreover, the legislation provides a basis for expanded enforcement against foreign subsidiaries of U.S. financial institutions and U.S. government contractors, as well as their parent companies. In addition, the Act's provisions provide new points of reference to help extend the potential reach of U.S. international enforcement by means of MLATs and other international judicial cooperation arrangements.

At this time, many provisions of the legislation are subject to interpretation in the process of implementation still ahead. It remains to be seen how the executive branch will approach the various provisions of the new law. Members of Congress have indicated that they view the Act's provisions as necessary to expand the scope and economic impact of U.S. sanctions on Iran, strengthen U.S. enforcement and set a benchmark of toughness and U.S. leadership for stronger action against Iran by other countries. The European Union and other countries are also developing new sanctions measures against Iran at this time, following the latest UN sanctions resolution against Iran earlier this month.

In the past, the asymmetry of U.S. sanctions against Iran with measures adopted by other countries has prompted threats of legal action against extraterritorial provisions of U.S. law under World Trade Organization disciplines and generated substantial diplomatic friction between the United States and many other countries, including key U.S. allies. At this time it is still unclear how the new sanctions framework provided in the measures just approved by the U.S. Congress will be perceived to align—or not—with the interests of other members of the international community. Ultimately, the effects and consequences of the new legislation are likely to be affected by the response of U.S. allies and key international actors Russia and China, as well as by how the new law is implemented and administered in Washington.

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