

Congress Enacts Significant New Iran Sanctions Legislation

June 25, 2010

On June 24, 2010, the U.S. Senate (by a vote of 99-0) and the U.S. House of Representatives (by a vote of 408-8) adopted new Iran sanctions legislation (the “Comprehensive Iran Sanctions Accountability and Divestment Act of 2010”) that broadens and intensifies U.S. sanctions policy against Iran. President Obama is expected to sign the measure into law soon.

The legislation greatly expands the circumstances in which the President is generally required to impose sanctions against non-U.S. companies for engaging in specified types of business in, or relating to, Iran. It also restricts the President’s latitude to forego sanctions in the face of actionable conduct by foreign companies.

In particular, the President is ordinarily required to sanction foreign companies doing business in Iran’s petroleum and refined petroleum product sectors (including financing/insuring/brokering shipments of refined petroleum products), and foreign banks that assist Iran’s WMD/terrorist activities. In some circumstances, affiliates of companies that engage in actionable conduct are at risk of sanctions, as well.

The new legislation will also allow states to divest their pension and other fund assets from foreign companies assisting Iran’s energy sector, and will restrict shipments of items to countries that divert shipments to Iran. Finally, it will substantially increase criminal penalties for violations of a variety of statutes regulating international trade by US persons.

The new legislation will mean that foreign business groups, particularly those in the energy, insurance and shipping sectors, and banks engaged in business with Iran should assess their activities vis-a-vis Iran to determine whether the new sanctions may apply to them. If so, they face the real possibility of being cut off from business with, not only the U.S. Government, but potentially the whole US market.

Introduction

The United States already broadly forbids and penalizes heavily most business with, and in, Iran by “US persons” (US citizens and residents; entities organized under US law; and all persons in the United States). In addition, the Iran Sanctions Act (the “ISA”) directs the President to impose

sanctions against non-US companies that make significant investments in Iran's petroleum sector.

To date, no President has imposed sanctions under the ISA. In the only case involving a Presidential determination under the ISA, in 1998, President Clinton waived imposition of sanctions against Total, Gazprom and Petronas for investments they had made in Iran's petroleum sector.

The principal motivation for this new set of sanctions was Congress's desire to find more effective tools to pressure Iran to halt what the US and other governments see as an Iranian nuclear weapons program. In part because of current and prior Administrations' failures to act and because foreign companies that had made substantial investments in Iran, including in its energy sector, continued to engage in significant business with the U.S. Government, Congress decided to intensify ISA sanctions policies and press the Administration to act. It also decided to expand sanctions against foreign banks and other companies doing business with Iran under new statutory authority. This report summarizes the legislation's principal provisions.

Amendments to the ISA

1. New Sanctions for Specified Activity in Iran's Petroleum/Refined Petroleum Sector – As originally enacted, the ISA provided for the imposition of two out of a menu of six possible sanctions against foreign companies knowingly investing \$20 million or more (or a combination of investments of at least \$5 million each, totaling \$20 million in a 12 month period) in the development of Iran's energy sector.

Up to now, the six possible sanctions have been:

- (1) denial of any guarantee, insurance, or extension of credit from the US Export-Import Bank;
- (2) denial of licenses for the US export of military or militarily-useful technology to the entity;
- (3) denial of US bank loans exceeding \$10 million in one year to the entity;
- (4) if the entity is a financial institution, a prohibition on its service as a primary dealer in U.S. government bonds; and/or a prohibition on its serving as a repository for U.S. Government funds (each counts as one sanction);

- (5) prohibition on U.S. Government procurement from the entity; and
- (6) restriction on imports from the entity.

The new legislation requires imposition of at least three out of a menu of nine possible sanctions (the original six plus three new possible sanctions) against foreign companies that knowingly make the requisite level of investments in Iran's energy sector, as described above. The three new possible sanctions are prohibitions on transactions subject to US jurisdiction and in which the sanctioned person has any interest involving (i) foreign exchange, (ii) transfers of credit or payments between financial institutions, or by, through, or to, any financial institution, and (iii) the acquiring, holding, withholding, using, transferring, withdrawing, transporting, importing or exporting any property subject to US jurisdiction and with respect to which the sanctioned person has any interest, or dealing in or exercising any right, power or privilege with respect to such property. These three new sanctions especially the last one would severely restrict the ability of a US person to have any business relationship with a sanctioned person.

The new legislation also requires imposition of three out of the same menu of nine possible sanctions against foreign companies that **knowingly**

- (i) sell, lease, or provide to Iran goods, services, technology, information or support with a fair market value of \$1 million or more, or which during a 12 month period have an aggregate fair market value of \$5 million or more, that could directly and significantly facilitate the maintenance or expansion of Iran's domestic production of refined petroleum products, including any direct and significant assistance with respect to the construction, modernization, or repair of petroleum refineries,
- (ii) sell or provide to Iran refined petroleum products (defined as diesel, gasoline, jet fuel, including naphtha-type and kerosene-type jet fuel and aviation gasoline) in the amounts set forth in (i) above, or
- (iii) sell, lease or provide to Iran goods, services, technology, information or support in the amounts set forth above, that could directly and significantly contribute to the enhancement of Iran's ability to import refined petroleum products. This includes (i) underwriting/insuring/reinsuring the sale, lease, or provision of refined petroleum products to Iran (see exception below), (ii) the financing or brokering of such sale, lease, or provision, or

(iii) providing ships or shipping services to deliver refined petroleum products to Iran.

2. Underwriting/Insurance/Reinsurance Sanctions Exception - An important exception to the imposition of sanctions exists for otherwise sanctionable underwriting/insurance/reinsurance activities if the President determines that the person has exercised due diligence in establishing and enforcing official policies, procedures and controls to ensure that the person does not underwrite or enter into insurance/reinsurance contracts covering the sale, lease, or provision of goods, services, technology, information or support that could directly and significantly contribute to the enhancement of Iran's ability to import refined petroleum products. This due diligence would include written procedures and controls and the appointment of a compliance official to monitor and enforce such procedures and controls.

3. Definition of "Knowingly" – Unlike the prior ISA which required a foreign company to have actual knowledge of an activity in order for it to be sanctionable, under the new legislation, for purposes of determining whether the above-described activities are sanctionable, the term "knowingly" (with respect to conduct or circumstance, or a result) has been broadened to mean that a person has actual knowledge, or should have known of the conduct, circumstance, or the result.

4. Persons Against Whom Sanctions May Be Imposed – Under the new legislation, sanctions are imposable not only against the person engaging in the sanctionable activity, but also against (i) that person's parent company if that parent had actual knowledge or should have known of the subsidiary's sanctionable activity, or (ii) an affiliate or subsidiary of a person found to be engaged in sanctionable activities if the affiliate or subsidiary knowingly engaged in sanctionable activities.

5. Sanctions for Nuclear Exports to Iran – Subject to certain exceptions, the new legislation prohibits the licensing of nuclear material and related items, services and technology subject to a nuclear cooperation agreement, to any country having primary jurisdiction over a company that has been sanctioned under the ISA for providing goods, services, technology or other items knowing that it would contribute materially to Iran's ability to acquire WMD or destabilizing numbers and types of advanced conventional weapons.

6. New Government Procurement Certifications – The new law requires that no later than 90 days after enactment, prospective U.S. Government contractors certify that neither they, nor persons owned or

controlled by them, engage in any of the above-described sanctionable activities. False certifications could result in the head of the relevant agency terminating the contract with that person or debarring/suspending the false certifier from future contracts for up to three years. The President could waive the certification requirement if he determines it is in the national interest to do so.

7. "Cooperating Country" Waiver – While waivers for entities in non-cooperating countries are limited to six months, the new legislation permits waiver of sanctions for up to 12 months if the President determines, at least 30 days before the waiver is to take effect, that the government exercising primary jurisdiction over the company in question is closely cooperating with the United States in multilateral efforts to prevent Iran from acquiring or developing WMD or destabilizing numbers and types of advanced conventional weapons, and such a waiver is vital to US national security interests. Twelve-month extensions of the waiver are possible. Ultimately, this provision treats cooperating countries differently only in terms of the length of the waiver available to companies from their countries. It is therefore notably weaker than the cooperating country exemption sought by the Obama Administration.

8. Investigations of Sanctionable Activities – Unlike the current law, which states that the President “should” pursue an investigation upon receipt of credible evidence of sanctionable activity, the new legislation requires the President to undertake an investigation in such circumstances. In addition, the President can decide not to initiate an investigation into possible ISA sanctionable activities if he determines that the subject person has stopped engaging in or taken significant verifiable steps towards stopping the subject activity, and has received reliable assurances that the person in question will not knowingly engage in the subject activity in the future. The new statute requires a range of publicly available reports to Congress with names of sanctioned firms and related information.

9. Presidential Waiver – Under the prior ISA, the President, following an investigation, could decide to waive the imposition of sanctions. Before new legislation, to waive imposition of sanctions, the President merely had to find that the waiver was “important” to US national security interests. Now, a waiver can be granted only if the President determines that it is “necessary” to US national security interests.

10. Effective Date – ISA sanctions are imposable with respect to investments or activities commenced on or after the date of enactment. Prior sanctionable investments in Iran's petroleum sector will be

sanctionable under the ISA as it existed prior to the date of enactment. However, persons who have engaged in, and continue to engage in, ISA WMD-related sanctionable activities become subject to the new sanctions.

11. Extension of ISA Authority – The new legislation extends the ISA's term from December 31, 2011 to December 31, 2016.

Additional Sanctions Against Iran Under New Statutory Authority

1. Iran Trade Embargo Made Statutory – The new legislation enacts into statutory law the principal aspects of the current US embargoes of Iran that have been imposed pursuant to a variety of Presidential Executive Orders and Office of Foreign Assets Control regulations.

2. Restrictions on US Correspondent and Payable-Through Accounts – The new legislation requires the Secretary of the Treasury to issue regulations within 90 days that, subject to a possible Presidential national interest waiver, will prohibit, or impose strict conditions on, the opening or maintaining in the United States of a correspondent or payable-through account by a foreign financial institution that knowingly:

- (i) facilitates the efforts of the Government of Iran (including the Islamic Revolutionary Guards Corps (“IRGC”) or their agents or affiliates) to acquire WMD or delivery systems for the same, or provides support for a Foreign Terrorist Organization,
- (ii) facilitates the activities of a blocked person under UN Security Council resolutions involving Iran,
- (iii) engages in money laundering to carry out an activity under (i) or (ii),
- (iv) facilitates efforts by the Central Bank of Iran to carry out an activity under (i) or (ii), or
- (v) facilitates a significant transaction(s) or provides significant financial services for the IRGC or any of their blocked/sanctioned agents or affiliates, or a financial institution whose property or interests in property are blocked in connection with Iran's proliferation of WMD or delivery systems for same, or Iran's support for international terrorism.

The cutting off of a foreign bank's US correspondent or payable-through accounts could impact not only the foreign bank involved, but also its

customers who rely on that bank for its US dollar and other US monetary transactions.

Penalties for violations of the prohibitions in items 1-2 above are those set forth in the International Emergency Economic Powers Act ("IEEPA") -- \$1 million and/or 20 years imprisonment for criminal violations, and the greater of \$250,000, or twice the value of the transaction for civil violations.

3. Prohibitions on Foreign Subsidiaries of US Financial Institutions –

Within 90 days of enactment, foreign persons owned or controlled by a domestic financial institution would, subject to a possible Presidential national interest waiver, be prohibited from engaging in transactions with or benefiting the IRGC or any of their blocked/sanctioned agents or affiliates. IEEPA civil penalties may be imposed against the foreign subsidiary's parent if the subsidiary engaged in the prohibited activity and the parent knew or should have known of the subsidiary's violation.

4. Documentary and Due Diligence Obligations for U.S. Financial Institutions –

Domestic financial institutions maintaining correspondent or payable-through accounts for foreign financial institutions will be required to complete and document one or more of the following:

- An audit of activities by the foreign financial institution of the type described in (i)–(v) in item 2 above;
- Reporting to the Treasury Department regarding transactions involving such activity;
- Certification that the foreign financial institution is not engaging in such activity; and
- Establishment of due diligence policies, procedures and controls reasonably designed to detect whether the Secretary of the Treasury has found the foreign financial institution to engage knowingly in such activity.

The definition of "financial institutions" for purposes of items 1-4 above includes insured banks, commercial banks or trusts, private bankers, US agencies or branches of foreign banks, credit unions, thrift institutions, SEC-registered broker-dealers, broker-dealers in securities or commodities, investment bankers or investment companies, currency exchanges, insurance companies, or other businesses or agencies engaged in similar activities, as determined by the Secretary of the

Treasury. The definitions of "domestic financial institution" and "foreign financial institution" will be determined by the Secretary of the Treasury.

5. New Sanctions for Iranian Human Rights Violations – The new legislation requires the President to prepare, within 90 days of enactment, and periodically thereafter, a list of Iranian Government and other officials who have, since June 12, 2009, been responsible for, or involved in, serious human rights abuses against citizens of Iran or their family members. Property of persons so identified will be blocked and, with very limited exceptions, will be denied US visas.

6. Sanctions Against Persons Exporting Sensitive Technology to Iran – Beginning 90 days after enactment, US agencies are prohibited from entering or renewing procurement contracts with persons exporting to Iran technology that can be used to restrict the free flow of unbiased information in Iran or disrupt, monitor or otherwise restrict speech of the people of Iran.

Increases in Criminal Penalties

The new legislation substantially increases potential criminal penalties for violations of three statutes potentially applicable to transactions with Iran in order to harmonize them with the criminal penalties available under IEEPA — the principal statute that has been used to authorize the Iranian embargo. The new criminal penalties and the relevant statutes are, as follows:

- UN Participation Act - \$1 million and 20 years imprisonment, or both (up from \$10,000 and 10 years in jail or both);
- Arms Export Control Act – 20 years imprisonment (up from 10 years imprisonment); and
- Trading with the Enemy Act - \$1 million and 20 years imprisonment, or both (up from \$100,000 for natural persons, and 10 years, or both).

State Divestment Initiatives

The new legislation authorizes state and local governments, no earlier than 90 days after notice and an opportunity for a hearing, to divest their assets from, or prohibit investments of such assets in:

- (i) persons found to have invested \$20 million or more in Iran's energy sector, (including providing oil or LNG tankers to Iran, or

This memorandum is intended only as a general discussion of these issues. It is not considered to be legal advice. We would be pleased to provide additional details or advice about specific situations. For additional information on this important topic, please feel free to call upon your Dewey & LeBoeuf relationship partner.

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products used to construct or maintain pipelines for transporting oil or LNG for Iran's energy sector), or

- (ii) financial institutions found to have extended \$20 million or more in credit to a person for 45 days or more for investment in Iran's energy sector.

More than 20 states and the District of Columbia have already adopted some form of divestment measure, which potentially would have been subject to being struck down by the courts for treading in an area usually within the purview of the federal government, were it not for the fact that the new legislation specifically rejects federal preemption.

The new legislation also provides a safe harbor (protection from lawsuits) for asset managers making divestment or non-investment decisions based on credible public information regarding Iran and Sudan.

Prevention of Diversion

The new legislation requires, within 180 days of enactment, and periodically thereafter, the Director of National Intelligence ("DNI") to identify countries that allow diversion through their countries to Iranian end users or intermediaries of certain sensitive US-origin goods, services, or technologies. The President must then identify the country as a "Destination of Diversion Concern" if he confirms the DNI's findings. Such confirmation will be based on a variety of factors, including the extent of the country's export control program and its willingness to cooperate with the United States to interdict diversion.

Subject to possible waiver, the President must begin requiring export licenses to a "Destination of Diversion Concern" with a presumption of license denial. The President can delay imposing this treatment if, for example, the country is taking steps to upgrade its export control system, interdict shipment diversions, or cooperate in government-to-government activities to strengthen its export control system.

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