

## **Sanctions Alert: The Brave New World of Doing Business with Iran**

Companies are facing an increasingly complex web of domestic and international sanctions regimes concerning transactions involving Iranian parties and investments in Iran. Developments in recent days suggest that Canadian firms doing business internationally must exercise extra vigilance to ensure compliance with trade and investment controls on Iran and in order to reduce the risk of negative financial and reputational exposure. The most significant of these developments include:

- (i) a fourth round of international sanctions against Iran, imposed under United Nations Security Council (UNSC) Resolution 1929 on June 9, 2010, and their implementation into the domestic laws of Canada and other UN members;
- (ii) increased Canadian enforcement and prosecution activity, including Canada's first prosecution under its Iranian sanctions on July 6, 2010; and
- (iii) measures imposed by the United States and the European Union that extend beyond the UNSC sanctions, and in particular, US extraterritorial measures signed into law on July 1, 2010 that impose sanctions on non-US companies doing business with Iran.

Any involvement of Iran or Iranian parties in a proposed transaction should trigger careful scrutiny. It can also be expected that merger and acquisition due diligence uncovering Iranian business activity potentially subject to these sanction regimes will present more challenges in closing the deal.

### **Canadian Sanctions and Controls on Doing Business with Iran**

Unlike the United States, which has generally prohibited its companies from trading with or investing in Iran since 1995, Canada does not currently maintain a ban on doing business with Iran. Canada does have a "Controlled Engagement Policy" in place that restricts diplomatic contacts and exchanges; however, this policy states that "Canada will not block the initiatives of private Canadian companies to trade with their Iranian counterparts." Indeed, Foreign Affairs and International Trade Canada's website identifies five priority sectors in Iran for the Canadian business community: Agricultural Technology & Equipment; Agriculture, Food & Beverages; Arts & Cultural Industries; Information & Communications Technologies; and Oil & Gas Equipment & Services.

Canadian measures that restrict doing business with Iran currently comprise (i) trade and investment controls imposed as a result of UN Security Council Resolutions involving nuclear and military items; and (ii) export controls on transfers from Canada of US-origin goods and technology to Iran.

### ***Nuclear-Related Activity and Screening of Designated Persons***

Canada's *Regulations Implementing United Nations Resolutions on Iran* (Iran Sanctions Regulations) contain a number of sanctions measures applicable to persons in Canada and Canadians outside of Canada.

The *Iran Sanctions Regulations* prohibit the sale, supply and transfer to Iran, from anywhere, of specified products and technology that may contribute to enrichment-related activities, re-processing or heavy water-related activities, or the development of nuclear delivery systems. This also includes a number of items on Groups 1 (Dual-Use) and 2 (Munitions) of Canada's *Export Control List* (ECL).

There is a ban on providing technical assistance, financial services, brokerage or other services to Iran related to the goods and technology discussed above. Making available to any person in Iran any property, financial assistance, or investment related to these goods and technology is also prohibited.

In addition, these rules impose an "assets freeze" against listed persons and entities engaged in nuclear-related activities ("Designated Persons"). This prohibits persons in Canada and Canadians outside Canada from any dealings in any property in Canada owned or controlled by Designated Persons, their subsidiaries and agents. There are also prohibitions against entering into or facilitating financial transactions related to such dealings, providing financial or related services in respect of such property, and making property or any financial or related services available to Designated Persons.

Canadian companies should therefore be screening for these listed Designated Persons to ensure that they are not engaging in prohibited dealings with these individuals and entities. In the event that they find they are in possession or control of property of Designated Persons, their subsidiaries or agents, details must be reported without delay to the Royal Canadian Mounted Police and to the Canadian Security Intelligence Services.

### ***Additional Obligations for Financial Institutions***

Federally and provincially regulated financial institutions in Canada, including foreign branches, are also required to review their systems and records on a continuing basis to determine whether they are in possession or control of property of Designated Persons, persons acting on their behalf, or persons owned or controlled by Designated Persons. Monthly reports as to whether such entities are in possession or control of this property must be submitted to the applicable financial regulatory agency.

In this regard, the Office of the Superintendent of Financial Institutions (OSFI) recently published *Instruction Guide: Designated Persons Listings and Sanctions Laws (June 2010)*. This publication addresses the application of Canadian sanctions laws pertaining to Iran and other countries, and provides guidance on these monthly reports, freezing and unfreezing assets, and related issues for federally regulated financial institutions.

In addition, in its [\*Notice: Financial Transactions Related to Jurisdictions Listed Herein \(June 30, 2010\)\*](#), OSFI reminds federally regulated financial institutions about the risks of doing

business with individuals and entities based in or connected to Iran and that enhanced due diligence measures must be applied to transactions with Iranian banks and payments destined to or received from Iran via intermediary banks.

### ***Recent Amendments to Canadian Sanctions***

Although only published more recently, amendments to Canada's Iran Sanctions Regulations came into force back on June 18, 2010. These are intended to implement UNSC Resolution 1929 into Canadian law.

These new measures include the following:

- (i) prohibition on persons in Canada and Canadians outside of Canada from making any property or any financial or other related service available to Iran, persons in Iran, Iranian entities or their agents for the purpose of investing in commercial activity in Canada involving uranium mining, production or use of specified nuclear materials and technology;
- (ii) addition of a number of individuals and entities to the list of Designated Persons subject to an assets freeze;
- (iii) addition of materials, equipment, goods and technology to the list of items that are prohibited for export to Iran;
- (iv) prohibition on providing any technology to Iran in respect of any activity related to ballistic missiles capable of delivering nuclear weapons; and
- (v) prohibition on the export to Iran of any battle tanks, armoured combat vehicles, large calibre artillery systems, combat aircrafts, attack helicopters, warships, missiles or missile systems.

Although the Canadian government has stated that it is prepared to consider and impose additional sanctions against Iran that extend beyond those agreed to under UNSC Resolution 1929, which could include additional measures targeting the energy and banking sectors (as is the case with the United States and the EU), such measures have yet to be announced.

### ***Canadian Controls on the Transfer of US-Origin Goods and Technology to Iran***

Pursuant to Item 5400 of the ECL, Canada controls for export all goods and technology that originate in the United States. An individual export permit must be applied for and obtained from Foreign Affairs and International Trade Canada's Export Controls Division for shipment of these items or transfer of technology to a handful of high-risk US-sanctioned countries, including Iran. This requirement applies regardless of whether the goods or technology are considered sensitive.

Item 5400 specifically excludes from control "goods that have been further processed or manufactured outside the United States so as to result in a substantial change in value, form or use of the goods or in the production of new goods" (assuming those items are not otherwise controlled elsewhere on the ECL). Accordingly, to the extent that goods or technology to be

transferred to Iran include US parts or components, it will be necessary to consider whether the process of incorporating those components resulted in a change in value, form or use of the goods or in the production of new goods.

### ***Stepped-Up Enforcement and Canada's First Prosecution***

The Canada Border Services Agency (CBSA), the agency with the primary responsibility of enforcing Canadian export rules, has been increasing its scrutiny of shipments to the Middle East. In particular, it has been detaining Canadian shipments of US origin as well as nuclear or military items destined for Middle East countries because of its suspicion that they are ultimately destined for Iran. CBSA officials have, on a number of recent occasions, informally indicated that they are carefully scrutinizing shipments to the United Arab Emirates, Hong Kong, and Malaysia among other countries, because of the high risk of diversion to Iran.

On July 6, 2010, Canada had its first successful prosecution under the Iran Sanctions Regulations. In that case, Mahmoud Yadegari had attempted to ship to Iran through Dubai dual-use pressure transducers that could be used in heating and cooling applications as well as in centrifuges for enriching uranium. An Ontario provincial court judge found that Yadegari “knew or was wilfully blind that the transducers had the characteristics that made them embargoed” and was therefore found guilty of violating the Iran Sanctions Regulations and other federal legislation governing export transactions.

### **New Extraterritorial US Measures on Doing Business with Iran**

Since 1996, the US *Iran Sanctions Act (ISA)* has provided for the imposition of sanctions against foreign firms that invest US\$20 million or more in one year in Iran's energy sector or that sell weapons of mass destruction or destabilizing numbers and types of conventional weapons to Iran. At the time of its initial enactment, the *ISA* was criticized by US allies for its extraterritorial impact. The first project found to be in violation of the *ISA* was a US\$2-billion contract for French, Russian and Malaysian companies to develop Iran's South Pars gas fields. However, the Clinton administration waived those sanctions, as part of a deal with the EU, which had challenged the *ISA* at the World Trade Organization. In return for the EU dropping its WTO complaint, the US also indicated it would not impose *ISA* sanctions on future EU investments in Iran.

Although there have not been any penalties imposed under the *ISA* to date, many have claimed that the legislation has had a chilling effect on investment in Iran, and more recently the Obama Administration has indicated that it is currently investigating a number of projects in Iran to assess compliance with the *ISA*.

The new US *Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (CISADA)*, signed into law by US President Obama on July 1, 2010, significantly tightens US sanctions against Iran through a patchwork of measures designed to strengthen sanctions as they apply to US entities, improve enforcement of the *ISA* by the US administration, and broaden the extraterritorial impact on non-US businesses, particularly in the energy and financial sectors.

### ***Petroleum Measures***

The *CISADA* amends the *ISA* and provides for the mandatory imposition of specified sanctions against non-US companies that:

- (i) make an investment of US\$20 million or more, or a combination of US\$5 million or more investments that total US\$20 million or more in a 12-month period, that directly and significantly contributes to the enhancement of Iran's ability to develop petroleum resources;
- (ii) sell, lease or provide to Iran goods, services, technology, information or support in respect of Iran's production of refined petroleum products, any of which either has a fair market value of US\$1 million or have an aggregate value of at least US\$5 million over a 12-month period;
- (iii) sell or provide to Iran refined petroleum products having a fair market value of US\$1 million or more, or having an aggregate value of at least US\$5 million over a 12-month period;
- (iv) sell, lease or provide to Iran goods, services, technology, information, or support that could directly and significantly enhance its ability to import refined petroleum products any of which has a fair market value of US\$1 million or that in aggregate over a 12-month period have a value of at least US\$5 million.

The *CISADA* adds three new measures to the list of sanctions to be applied against non-US companies found to be engaging in sanctioned activities under the *ISA*. Now, the US President must impose at least three of the following nine sanctions against such entities:

- (i) prohibition on any foreign exchange transactions subject to US jurisdiction and in which the sanctioned person has any interest (new);
- (ii) prohibition on any transfers of credit or payments between financial institutions or by, through, or to any financial institution, to the extent that such transfers or payments are subject to US jurisdiction and involve any interest of the sanctioned person (new);
- (iii) prohibition against a wide range of activities involving property subject to US jurisdiction and with respect to which the sanctioned person has any interest (new);
- (iv) denial of Export-Import Bank loans, credits, or credit guarantees for US exports to the sanctioned person;
- (v) denial of licences for the US export of military or militarily useful technology;

- (vi) denial of US bank loans to the sanctioned person exceeding \$10 million in one year;
- (vii) if the sanctioned person is a financial institution, prohibition on its service as a primary dealer in US government bonds and/or prohibition on its serving as a repository for US government funds;
- (viii) prohibition on US government procurement of goods or services from the sanctioned person; and
- (ix) prohibition on imports into the United States from the sanctioned person.

Although the legislation provides for presidential authority to waive, on a case-by-case basis, the application of these provisions where the company's home country is considered to be "closely cooperating" with the United States in multilateral efforts to prevent Iran from acquiring weapons of mass destruction, the conditions attached to such waivers could make them difficult to obtain.

#### ***Foreign Financial Institution Measures***

The new US measures are also designed to deny access to the US financial system to foreign financial entities engaging in certain activities involving Iran. These include facilitating Iran's efforts to acquire or develop weapons of mass destruction or provide support to foreign terrorist organizations, and facilitating transactions or providing financial services for Iranian financial institutions blocked under US law, including Bank Melli and Bank Saderat.

The *CISADA* requires that regulations be issued to prohibit the opening or maintenance in the United States of a correspondent account or a payable-through account by a non-US financial institution found to be engaging in such activities. In addition, US financial institutions maintaining a correspondent account or payable-through account in the United States for a non-US financial institution will be required to perform audits, report, and/or issue certifications to the US Treasury Department in respect of the non-US financial institution's activities in this regard.

#### ***Other Measures Potentially Impacting Canadian Business***

Although the balance of the *CISADA* largely focuses on measures impacting US entities, there are certain aspects of the legislation that may also have a significant effect on Canadian companies, including:

- (i) prohibition on US government agencies entering into or renewing contracts for the procurement of goods and services with persons that export to Iran certain sensitive technology, including items that restrict the free flow of information in Iran or that monitor or restrict speech of the Iranian people;

- (ii) requirement that a prospective contractor with the US government certify that it and any person controlled by it does not engage in activities subject to sanction under the ISA;
- (iii) authority for US State and local governments to divest from companies doing business in Iran's energy sector; and
- (iv) although it is unclear at this point and depends upon future implementation of the *CISADA*, some have noted that the existing exceptions in US law that allow for the re-export of US-origin content to Iran from third countries, such as Canada, may be significantly restricted.

### **Export Control and Economic Sanction Compliance**

Given recent developments and the increasingly complex landscape Canadian companies face regarding trade and investment sanctions with Iran and other countries, it is critically important that internal compliance programs are in place to minimize financial and reputational risk.

The basic elements of such systems include developing compliance manuals and standard operating procedures, using screening lists, appointing compliance officers, providing education and training programs, reviewing contracts, conducting compliance audits, identifying potential violations, making voluntary disclosures, and addressing conflicts between Canadian and foreign trade controls.

A compliance system should provide for the effective screening of transactions against "red flag" destinations or parties. If any of these countries, entities, organizations or individuals are – or may be – involved, the activity should be carefully scrutinized for compliance with applicable trade controls and economic sanctions. At the present time, for Canadian companies those red-flagged destinations and parties should include:

Belarus	Eritrea	Liberia	Sudan
Burma	Guinea	North Korea	Syria
Côte d'Ivoire	Iran	Pakistan	Zimbabwe
Cuba	Iraq	Sierra Leone	
Democratic Republic of the Congo	Lebanon	Somalia	

and the individuals and entities listed pursuant to regulations targeting Al-Qaida and the Taliban, the *Suppression of Terrorism Regulations* and the *Criminal Code*. Canada maintains economic sanctions or trade controls of various degrees and scope in respect of all of these destinations.

McCarthy Tétrault's International Trade and Investment Law Group continues to closely monitor developments in economic sanctions and export controls concerning Iran and other countries and entities subject to these measures. Our Group's practitioners have significant expertise in these matters and regularly assist clients in developing solutions to compliance and enforcement issues in this area. We are available to advise on these or any other international trade and investment matters.