Alert 10-164 [Mobile and Print-friendly version]

Increased Iranian Sanctions: Washington Responds to Continued Nuclear Development by Tehran

On July 1, 2010, President Barack Obama, preceded by Congressional voting signaling overwhelming support, signed into law the Comprehensive Iran Sanctions Accountability and Divestment Act ("Act"). The Act is an effort by the United States to hinder what appears to be Iran's intent to develop nuclear weapons. Action by the United States comes at a time when several countries are modifying their sanction policies in response to Iran's actions. In recent weeks, the United Nations, the European Union, and the United Kingdom, among others, have all enacted resolutions or sanctions directed at Iran. While many elements of the Act must be implemented by regulations, and are therefore unknown at this time, this article summarizes the major changes that are now known.

Increased Energy Related Sanctions

A primary purpose of the Act is to pressure the government of Iran to abandon its perceived goal of furthering its weaponized nuclear capabilities. To achieve this goal, the Act calls for the president, absent a waiver, to impose at least three sanctions upon entities who invest in the energy sector of Iran. This imposition of three sanctions is an increase from the previous sanction regime in which only two or more sanctions were to be imposed. In addition to the increase in the number of sanctions to be imposed, the Act increases the number of sanctions available to the president from six to nine.

As outlined below, the Act addresses and sanctions three means of investment in the Iranian energy sector. Within each classification of investment, the Act proscribes sales, leases, and provisions of services that reach a certain financial threshold. However, while the financial value of each sanctioned activity is clear, the Act uses broad language to define the prohibited action. Specifically, the Act sanctions actions that will "directly and significantly" impact the Iranian energy sector, without ever defining what constitutes direct or significant. Because the terms are intentionally undefined, it is reasonable to presume that the intent of Congress is for the Act to be interpreted as broadly as possible.

Development of Petroleum Resources

The Act calls for the imposition of sanctions upon a person who knowingly makes an investment of at least $20 million, or over a one-year period makes a series of contributions that aggregate to $20 million. The prohibited investments under this section are those that directly and significantly contribute to the enhancement of Iran's ability to develop petroleum resources.

Production of Refined Petroleum Products

The Act further calls for the imposition of sanctions upon a person who sells, leases, or provides goods, services, technology, information, or support to Iran that could significantly facilitate the maintenance or expansion of Iran's domestic production of refined petroleum products. The Act makes clear that this definition includes direct and significant assistance with construction, modernization, or repair of petroleum refineries. In order for provision of goods and services to be sanctioned under this section, such goods and services must have a fair market value of at least $5 million or during a one-year period have an aggregate fair market value of $5 million.

Export of Refined Petroleum to Iran

The final energy-related sanction prohibits the knowing sale of refined petroleum products to Iran, or the provision of goods and services that could directly and significantly contribute to the enhancement of Iran's ability to import refined petroleum products. The goods that are sold, leased, or provided must have a fair market value of at least $1 million or $5 million if done over an aggregate of one year. This section does contain an exception for persons who perform underwriting services or insurance services, on the condition that the president determines the person has exercised due diligence to ensure they do not engage in actions that violate the sanction.

Modification to Banking Regulations

In addition to retarding the growth of Iran's energy sector, the Act addresses those persons and entities who participate in Iran's banking industry. The banking section of the Act (section 104) addresses the activities of foreign financial institutions ("FFI") and domestic financial institutions ("DFI"), and lists requirements for financial institutions that maintain accounts for FFIs.

Precisely which financial institutions are covered by the scope of these regulations is unknown at this time, as the Act defines neither FFIs nor DFIs. Rather, the Secretary of the Treasury is instructed to prescribe regulations within 90 days that will include definitions of FFI and DFI.

Foreign Financial Institutions

The Act urges the president to use his authority to directly impose sanctions on the Central Bank of Iran, and other Iranian financial institutions engaged in proliferation activities or activities that support "terrorist groups."

Whether or not the president chooses to impose sanctions, the legislation requires the Treasury Department (within 90 days) to impose regulations on FFIs engaged in certain activities. Specifically, the Secretary of the Treasury is required to create regulations to either prohibit, or impose strict conditions upon, opening or maintaining a correspondent account or a payable-through account in the United States by an FFI if such an FFI engages in any of a number of listed activities. The activities that will trigger imposition of the prohibition or condition include:

- FFI facilitating the efforts of the government of Iran (including efforts of Iran's Revolutionary Guard Corps or its agents) to acquire or develop weapons of mass destruction or their delivery systems
- FFI facilitating the efforts of the government of Iran to provide support for organizations designated as foreign terrorists, or to support acts of terrorism
- FFI facilitating the activities of a person subject to UN Security Counsel financial sanctions
  FFI facilitating a significant transaction for: Iran's revolutionary Guard Corps, or agents, who are sanctioned under U.S. law; or a financial institution whose property is likewise blocked under U.S. law

Domestic Financial Institutions

The Act calls for the Secretary of the Treasury to prescribe regulations that prohibit any person owned or controlled by a DFI from knowingly engaging in a transaction with, or engaging in a transaction that benefits, Iran's Revolutionary Guard Corps. This prohibition also includes agents or affiliates of Iran's Revolutionary Guard Corps whose property or interests are blocked by the International Emergency Economic Powers Act.

Requirements for Financial Institutions Maintaining Accounts for Foreign Financial Institutions

Domestic financial institutions that maintain either correspondent accounts or payable-through accounts within the United States for FFIs will be subject to heightened regulations. The precise regulations are at this time unknown, as they are to be created by the Secretary of the Treasury; however, the regulations are to require DFIs to engage in one or more of the following:

- Perform an audit of activities governed by the Act that may be carried out by the FFI
- Report to the Treasury on transactions or other financial services provided with respect to governed activity
- Certify, to the best knowledge of the DFI, that the FFI is not knowingly engaging in any such activity
- Establish due diligence policies, procedures, and controls reasonably designed to detect whether the Secretary of the Treasury has found the FFI to knowingly engage in any such activity

Contracting with the U.S. Government

To ensure that no U.S. government funds are being sent to Iran, or to entities that transact business with Iran, the Act creates a heightened certification requirement for government contractors. Within 90 days of enactment of the Act, the Federal Acquisition Regulation "shall be revised to require a certification from each person that is a prospective contractor that the person, and any person owned or controlled by the person, does not engage in any activity for which sanctions may be imposed."

State Authorization of Divestment

Title II of the Act authorizes state and local governments to enforce their own sanction-like activity against foreign companies that invest in the energy sector of Iran. Provided that the state or local government complies with certain due process requirements, it is permitted to do one of two things. First, the government body has the option to divest from specified persons, with the support of the United States government, the assets of the state or local government. Assets included here are public monies, such as any pension, retirement, annuity, endowment fund, or similar instrument, which is controlled by the state or local government. Second, the government body is permitted to prohibit investment of assets in persons investing in the energy sector of Iran. The investment assets includes a commitment or contribution of assets, a loan or other extension of credit, and the entry into or renewal of a contract for goods or services.

This provision is significant because of the scope of "persons" subject to divestment. This section makes no distinction between U.S. and foreign persons. For purposes of this section, the "person" who is subject to divesture of assets, or prohibition of investment, is "a natural person, corporation, company, business association, partnership, society, trust, or any other nongovernmental entity, organization, or group; any governmental entity or instrumentality of a government, including a multilateral development institution...; and any successor, subunit, parent entity, or subsidiary of, or any entity under common ownership or control with, any entity described [in this definition]."

By including parent companies and subsidiaries in the definition of person, this law requires international companies that transact business with U.S. states to monitor, and potentially terminate, the activities of their subsidiaries, and parent companies, or else be subject to divestment of state assets, including ineligibility for state and local contracting.

Efforts to Curb Diversion of Goods, Services and Technology to Iran

Title III of the Act serves as an effort by the United States government to apply international pressure to, as well as to increase the export compliance requirements for, countries that assist corporations and persons in avoiding U.S. law. This international pressure is created because the Act requires the Director of National Intelligence to submit to the executive branch a report identifying countries that allow the diversion of goods through such country into Iran. The diverted goods that trigger the reporting include: U.S. origin goods; goods that would make a material contribution to Iran's development of weapons (including nuclear, chemical, and biological, as well as their delivery methods); goods that support international terrorism; and goods that are prohibited from export to Iran by virtue of a UN Security Council resolution.

In order to curtail diversion to Iran, the Act imposes an additional licensing requirement for export to countries that permit diversion. If the president determines that a country does allow substantial diversion of goods, services, or technology, then the president shall designate that country as a Destination of Diversion Concern. Once a country is identified as a Destination of Diversion Concern, the president shall impose a license requirement for export of goods, services or technology to that country, under either the Export Administration Regulations or the International Traffic in Arms Regulations (whichever is applicable). These license requirements are subject to a presumption of denial.

Conclusion

Through its sanction program, the United States is attempting to impair the ability of Iran to produce nuclear weapons. In order to achieve this goal, the United States has created a sanction regime in which persons and entities who wish to continue transacting financial business with the United States must ensure that any activities they may engage in with respect to Iran do not conflict with U.S. sanction policy. While several of the details of the Act must be codified through regulations, the Act is clear that the United States does not wish to engage in business with those who engage with Iran.

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Reed Smith will continue to monitor this legislation, as well as the forthcoming regulations, in addition to other trade sanction issues. Please contact one of the authors, or your usual Reed Smith contact for more information or assistance.

For additional information regarding impacts for the international shipping industry, see RS Shipping Alert 10-155.

Leigh T. Hansson
Partner
Washington, D.C.
+1 202 414 9394

Michael A. Grant
Associate
Washington, D.C.
+1 202 414 9238

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