LATHAM & WATKINS

Client Alert Commentary

Latham & Watkins Export Controls, Economic Sanctions & Customs Practice

November 6, 2018 | Number 2408

Top 10 Things to Know About Expanded US Sanctions on Iran

Withdrawal from the Iran nuclear agreement triggers full implementation of US sanctions, including threat of "secondary" sanctions on non-US persons dealing with Iran.

As reported in the Latham *Client Alert* dated May 10, 2018, President Trump announced on May 8 that the United States was withdrawing from the Joint Comprehensive Plan of Action (JCPOA), the January 2016 nuclear non-proliferation agreement among China, France, Germany, Russia, the United Kingdom, the US and Iran. The US withdrawal triggered the re-imposition of Obama-era US sanctions that had been suspended under the terms of the JCPOA. After a staged approach ending on November 4, 2018, the full arsenal of US primary and secondary sanctions against Iran is now in place. As Latham reported previously, these sanctions have the potential to reach any person or entity in the world that engages in transactions or dealings with Iran.

Below are answers to 10 key questions about the recent expansion of US sanctions relating to Iran.

1. What new limitations and risks do US persons and entities now face?

As of November 5, 2018, the "primary sanctions" that the US eased under the terms of the JCPOA have been fully re-imposed. "Primary sanctions" are those that apply to activities that have a jurisdictional nexus with the US — including, for example, transactions involving US persons or overseas subsidiaries of US companies.

While it was a party to the JCPOA, the US allowed overseas subsidiaries of US companies to engage in limited trade with Iran, under the terms of General License H issued by the US Treasury Department's Office of Foreign Assets Control (OFAC). OFAC revoked General License H on June 27, 2018, and replaced it with a general license allowing overseas subsidiaries until November 4, 2018 to "wind down" Iran-related transactions previously authorized under General License H. Now that General License H has been revoked and the corresponding wind-down general license has expired, non-US persons "owned or controlled" by a US person are prohibited from engaging in transactions — directly or indirectly — with the Government of Iran or parties subject to its jurisdiction to the same extent as US persons, as was the case before the implementation of the JCPOA.

2. What risks do non-US persons and firms face?

Secondary sanctions are designed to deter and penalize certain activities of non-US persons that may not be covered by primary sanctions. The most significant implication of the US' withdrawal from the JCPOA is the re-imposition of secondary sanctions, which apply to non-US firms and individuals, even in the absence of a jurisdictional nexus with the US. On August 6, 2018, the US re-imposed an initial round of secondary sanctions and as of November 5, 2018, all of the secondary sanctions the US had suspended under the JCPOA have been re-imposed. In a joint press conference with US Treasury Secretary Steven Mnuchin on November 5, US Secretary of State Mike Pompeo warned that the US will aggressively enforce its sanctions, cautioning businesses around the world to avoid violating the measures.

Secondary sanctions are designed to punish non-US actors that engage in certain transactions related to specified sectors of the Iranian economy. In addition, a non-US person who engages in a significant transaction with certain Iranian parties on OFAC's Specially Designated Nationals and Blocked Persons List (SDN List) — which, as discussed below, OFAC expanded on November 5 — could lead to US secondary sanctions. Such Iranian parties have the notation "Additional Sanctions Information — Subject to Secondary Sanctions" in their SDN List entry.

Secondary sanctions relating to Iran are drawn from a predefined menu of penalties. These include a prohibition on foreign exchange transactions subject to US jurisdiction; the denial of Export-Import Bank assistance; the denial of US export licenses; the denial of certain loans from US financial institutions; a ban on US government procurement; and blocking sanctions.

3. Are non-US financial institutions restricted from dealing with Iran?

The secondary sanctions are primarily intended to restrict Iran's ability to access international financial markets, including those located outside of the US. So US secondary sanctions target non-US financial institutions that engage in certain Iran-related transactions, including transactions with the Central Bank of Iran and certain designated Iranian financial institutions on the SDN List.

In its FAQs, OFAC notes that the US has re-imposed sanctions on the provision of specialized financial messaging services to the Central Bank of Iran and Iranian financial institutions. With the goal of isolating Iran's banking sector from the rest of the world, this sanction appears specifically to target the Society for Worldwide Interbank Financial Telecommunication (SWIFT), which provides global financial messaging services. In his November 2, 2018 remarks on the re-imposition of secondary sanctions, Treasury Secretary Mnuchin indicated that SWIFT would be subject to secondary sanctions unless it disconnected designated Iranian financial institutions from its network as soon as technologically feasible.

Given this and other practical difficulties that non-US financial institutions are likely to face in connection with even non-sanctioned trade in goods and services with Iran, it is likely that such financial institutions will play a significant role in defining whether such trade is possible. In recent years, non-US banks have been major targets of US sanctions enforcement actions, and they often refuse to handle payments or financing relating to Iran even where such activity may be permitted under US sanctions. This "chilling" effect on the international banking system will certainly continue in the days ahead, making it difficult for companies to pursue even non-sanctioned business with Iran.

4. What sectors of the Iranian economy are most affected by new sanctions?

Following from the end of the 180-day wind-down period, new secondary sanctions targeting Iran that take effect on November 5, 2018 include sanctions on:

- Iran's port operators as well as shipping and shipbuilding sectors, including on the Islamic Republic of Iran Shipping Lines, South Shipping Line Iran, and their affiliates
- Petroleum-related transactions with, among other companies, the National Iranian Oil Company (NIOC), Naftiran Intertrade Company (NICO), and National Iranian Tanker Company. Covered transactions include the purchase of petroleum, petroleum products, or petrochemical products from Iran
- Significant transactions by non-US financial institutions with the Central Bank of Iran and designated Iranian financial institutions under Section 1245 of the National Defense Authorization Act for Fiscal Year 2012
- The provision of specialized financial messaging services to the Central Bank of Iran and Iranian financial institutions described in Section 104(c)(2)(E)(ii) of the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010
- The provision of underwriting services, insurance, or reinsurance
- Iran's energy sector

5. Which parties in Iran are most affected?

On November 5, 2018, OFAC added more than 700 individuals, entities, aircraft, and vessels to the SDN List. A Treasury Department Press Release characterized these designations as OFAC's "largest ever single-day action targeting the Iranian regime." More than 400 of these parties — including many Iranian financial institutions, such as the Central Bank of Iran — had been removed from sanctions when the JCPOA was implemented, on January 16, 2016. The other 300 or so parties designated on November 5 were not previously identified on an OFAC list.

Nearly 300 of the parties that were added back to the SDN List on November 5, 2018 meet OFAC's regulatory definitions — under the Iranian Transactions and Sanctions Regulations (ITSR) — of "Government of Iran" or "Iranian financial institution." This action is significant because, prior to its withdrawal from the JCPOA, the US elected not to expose non-US persons to secondary sanctions in connection with significant financial transactions with such parties. Notably, US persons were required, pursuant to Executive Order 13599 (EO 13599), to block the property of such persons (identified on OFAC's 13599 List) that came into their possession or control.

As a result of OFAC shifting these parties back onto the SDN List (and OFAC correspondingly removing the 13599 List from its website and eliminating references thereto in the ITSR), non-US persons, including non-US financial institutions, once again face risks under US secondary sanctions for engaging in significant transactions with certain of these parties, depending the basis of the designation of those parties. Non-US persons continue to be permitted to engage in transactions with Iranian financial institutions that have been added to the SDN List *solely* on the basis of their prior inclusion on the 13599 List. However, transactions with all other Iranian SDNs potentially expose non-US banks and non-banks to US secondary sanctions (with certain limited exceptions for humanitarian transactions relating to food items, medicines, and medical devices).

Moreover, non-US persons that are parties to credit agreements or other contracts that include sanctions-related representations and covenants — which typically prohibit dealings with SDNs — should consider whether the newly expanded SDN List impacts their ability to comply with such provisions going forward.

6. Are waivers available for non-US persons dealing with Iran?

As a general matter, there is no formal legal process through which a non-US person can secure a waiver from the US government in order to conduct a transaction that could expose the non-US person to secondary sanctions. However, to mitigate the impact that the re-imposition of secondary sanctions on Iran's energy sector may have on certain countries that significantly depend on Iranian crude, the State Department has issued so-called "significant reduction exemptions" (or SRE waivers) to China, India, Japan, South Korea, Italy, Greece, Taiwan, and Turkey.

These waivers will allow these eight countries to continue temporarily buying Iranian crude as long as they work to reduce imports to zero. The SRE waiver also permits non-US financial institutions in the countries receiving the waiver to engage in significant financial transactions with the Central Bank of Iran and Iranian financial institutions provided (i) those transactions relate to bilateral trade between the waiver country and Iran and (ii) the funds owed to Iran are held in an account in the waiver country and not repatriated to Iran.

In a Department of State briefing on November 2, 2018, Secretary of State Pompeo explained these waivers were warranted because the eight countries "have demonstrated significant reductions in their crude oil and cooperation on many other fronts and have made important moves towards getting to zero crude oil importation." The waivers expire in 180 days, and in a briefing on November 2, 2018, Department of State Special Representative for Iran Brian Hook stated that the US is not planning to grant additional SREs at the end of that period.

7. How will the secondary sanctions process work?

Because US secondary sanctions are essentially foreign policy tools as well as penalty measures, the sanctions are administered and enforced by both the Department of State and OFAC. OFAC (in consultation with the Department of State) has primary responsibility for imposing **blocking or correspondent account** secondary sanctions related to:

- The purchase or acquisition of US bank notes or precious metals by the Government of Iran
- Transactions with NIOC, NICO, or the Central Bank of Iran
- Transactions with SDNs
- Persons who are a part of the energy, shipping, or shipbuilding sectors of Iran, or who operate a port in Iran
- Goods or services used in connection with the automotive sector of Iran

The Department of State (in consultation with OFAC) has primary responsibility for imposing **"menu-based"** secondary sanctions related to:

- Goods or services used in connection with the automotive sector of Iran
- The purchase, acquisition, sale, transport, or marketing of petroleum or petroleum-products from Iran
- The purchase, acquisition, sale, transport, or marketing of petrochemical products from Iran

8. Will the European Union take action to counter US sanctions?

As Latham reported in a *Client Alert* dated August 9, 2018, the EU reacted to the risks EU companies faced as a result of the US government decision to re-impose secondary sanctions on Iran by adopting Commission Delegated Regulation (EU) 2018/1100. This Regulation amended the EU Blocking Statute (Council Regulation (EC) No. 2271/96), a piece of EU legislation intended to protect EU persons from the effect of certain extraterritorial US legislation listed in its Annex. The amendment expanded the scope of the Annex to include additional US Iran sanctions laws and regulations, including OFAC's ITSR.

The EU is also continuing its efforts to create a special purpose vehicle (SPV) to facilitate transactions with Iran. Although details have yet to be announced, there are indications that the SPV will provide an alternative mechanism for processing payments to and from Iran, enabling EU companies to avoid needing to rely on international financial institutions that remain exposed to US sanctions.

The amended EU Blocking Statute, which came into force on August 7, 2018, (a) prohibits persons operating within the EU from complying with US sanctions listed in the Annex to the EU Blocking Statute, including US secondary sanctions, (b) allows affected persons to recover damages arising from the effects of the US sanctions, and (c) renders foreign court rulings based on the US sanctions invalid within the EU.

Persons operating in the EU (including EU subsidiaries of US companies) consequently face competing legal obligations with regard to business related to Iran. On the one hand, such persons face potentially significant penalties under US sanctions, and on the other hand, they are required to comply with the EU Blocking Statute as a matter of EU law.

Businesses and financial institutions operating internationally will need to address these potential conflicts with care. In particular, such entities will need to ensure that their sanctions compliance policies do not run afoul of the EU Blocking Statute, and will need to remain vigilant not only to comply with US and EU sanctions and related legal obligations, but also to anticipate the risk of civil actions based on suspected non-compliance with the EU Blocking Statute. Additionally, although the proposed EU SPV may enable European companies to avoid the blocking of their transactions by international banks, use of the SPV system could still expose EU companies to US secondary sanctions under the theory that they are circumventing US sanctions.

9. How long will US sanctions remain in effect?

Because the sanctions described above have been implemented through an Executive Branch action under broad statutory authority, the President has the power to suspend or lift most or all of these measures. In the present climate, however, there does not appear to be any realistic chance that the Trump Administration will take steps to ease these sanctions or any other sanctions on Iran. To the contrary, the Administration has expressed a strong commitment to tougher sanctions on Iran. By calling for changes in Iran's support for terrorism, the Administration has tied the measures to broader policy objectives that go beyond the nuclear proliferation issue, which was the original basis for the JCPOA.

The US Congress has also demonstrated strong bipartisan support for applying pressure on Iran, even if certain Democrats (and even some Republicans) might continue to favor an eventual return to the JCPOA (and an ancillary easing of sanctions). Thus, as a political matter, these new sanctions likely will remain in place for some time.

That said, the Trump Administration — through the Department of State and OFAC — will have virtually unfettered discretion in deciding whether and how to pursue secondary sanctions, as well as against which parties and for which types of transactions. In this sense, even while sanctions remain in place, the level to which they will actually be applied and enforced will turn on a range of factors, including the response and behavior of the Iranian government as well as the degree to which trading partners of the US may elect to push back on secondary sanctions.

10. Is a new nuclear agreement with Iran a possibility?

The current prospects for any formal easing of the US sanctions appear to be low. While there is a theoretical possibility that a new nuclear agreement could emerge in the coming months, a new agreement would require all of the original parties to reach consensus on terms that would likely impose more stringent restrictions on Iran than the JCPOA. There is little evidence to suggest that the non-US parties are prepared to renegotiate the original terms. To the contrary, as noted above, the European parties to the JCPOA have continued to express their commitment to adhering to the terms of the JCPOA, and, through the EU, European parties may even be prepared to take steps to counter the effects of US secondary sanctions.

In the days ahead, non-US companies seeking to do business with Iran will face growing pressure to weigh the potential benefits against the risks of US secondary sanctions. Notwithstanding the public effort by the EU and other parties to the JCPOA to oppose these US sanctions, there is ample evidence that international businesses are already electing to forego the Iranian market to avoid risking their operations in and access to the US market.

If you have questions about this *Client Alert*, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

Les P. Carnegie
les.carnegie@lw.com
+1.202.637.1096
Washington, D.C.

Charles Claypoole
charles.claypoole@lw.com
+44.20.7710.1178
London

William M. McGlone
william.mcglone@lw.com
+1.202.637.2202
Washington, D.C.

Robert E. Sims
bob.sims@lw.com
+1.415.395.8127
San Francisco

Eric S. Volkman
eric.volkman@lw.com
+1.202.637.2237
Washington, D.C.

Annie E. S. Froehlich
annie.froehlich@lw.com
+1.202.637.2375
Washington, D.C.

Elizabeth K. Annis
elizabeth.annis@lw.com
+1.415.395.8007
San Francisco

Andrew P. Galdes
andrew.galdes@lw.com
+1.202.637.2155
Washington, D.C.

Bridget Reineking
bridget.reineking@lw.com
+1.202.637.1015
Washington, D.C.

Robert Price
robert.price@lw.com
+44.20.7710.4682
London

You Might Also Be Interested In

Top 10 Things to Know About President Trump's Decision to Withdraw from the Iran Nuclear Agreement

Top 10 Things to Know about the Implementation of the Iran Nuclear Agreement

US Treasury Department's New Designations Under the Russia-Related Sanctions: 3 Key Takeaways

US Treasury Department Issues Anticipated List of Russian Parties, Pursuant to Recent Legislation

---