



Proposed new US sanctions against Iran would target non-US firms

Each house of US Congress has passed its own version of legislation that would tighten US economic sanctions against Iran, particularly its petroleum sector. The proposed new sanctions would primarily target non-US firms by broadening an existing statute known as the Iran Sanctions Act. The new legislation may also accelerate the wave of local US initiatives to divest from companies with business in Iran, increase compliance risks for US companies with non-US subsidiaries that do business with Iran and further tighten the US trade embargo against Iran.

Since 1995 the United States has had a broad trade and financial embargo in place against Iran, prohibiting virtually all trade and investment activities with Iran by US persons or any other person within the United States. In recent years these economic sanctions have been enforced both against US companies and against non-US companies when the US government saw a sufficient jurisdictional nexus with the United States.

In addition to this general embargo, a separate US statute was enacted in 1996, targeting non-US companies that make significant investments in Iran's petrochemical sector. Although this law, the Iran Sanctions Act (ISA), has never been enforced, it could be applied to any person, anywhere in the world, regardless of whether they have any ties or contact with the United States. US Congress is now poised to expand the ISA and seek to compel President Obama to enforce it against non-US companies that engage in certain types of business with Iran.

The Iran Sanctions Act

Although the Obama Administration has continued to indicate it seeks dual "pressure and diplomacy" tracks in its efforts to respond to Iran's uranium enrichment activities, the US Congress now appears to be focused solely on the pressure track. Of the numerous Iran sanctions bills introduced in Congress since 2008, a bill that passed in the House of Representatives and a bill that passed in the Senate are poised to be reconciled into final legislation.

Both parties in Congress have stated their intent to hammer out compromise legislation based on the two bills and send it to the president for signature as soon as possible.

Both bills propose expanding the ISA, which was initially enacted in 1996 as the Iran and Libya Sanctions Act and was amended and extended in 2006. The ISA calls on the US president to investigate investments in Iran's petroleum sector and exports of sensitive items to Iran. It enables the president to impose enumerated sanctions on any US or non-US person he deems to have engaged in certain listed forms of investment or trading activities with Iran.

ISA sanctions are currently available against any person the president determines has:

- invested \$20m or more in any 12-month period in a manner that significantly contributes to Iran's ability to develop its petroleum resources; or
- exported goods, services or technology to Iran knowing they would contribute to Iran's ability to acquire or develop chemical, nuclear or biological weapons or advanced conventional weapons.

The president may waive sanctions against a particular person if doing so is "important to the national interest" of the United States. As a practical matter, no US president has ever exercised ISA authority to sanction any person. The legislation pending in Congress seeks to change that status quo.

The proposed US legislation

Senate Bill 2799, the Comprehensive Iran Sanctions, Accountability and Divestment Act of 2009, differs in several significant ways from the House bill, HR 2194, the Iran Refined Petroleum Sanctions Act of 2009. However, both bills would amend the ISA by adding new activities involving Iran for which the president may impose sanctions and including three additional mandatory financial sanctions against persons determined to have engaged in any of those activities.

Specifically, both bills would make ISA sanctions available for any person the president determines has provided “refined petroleum products” to Iran, has contributed to Iran’s ability to import such products or has facilitated the maintenance or expansion of Iran’s domestic production of such products.¹ The related definitions would specify that the disfavored activities include “underwriting, insuring or reinsuring”, or “financing or brokering”, transactions that contribute to Iran’s ability to import refined petroleum products, and providing ships or shipping services to deliver refined petroleum products to Iran.

Both bills may also prohibit the federal government from entering into procurement contracts with persons that are engaged in any of the disfavored activities involving Iran under the ISA, or that export certain sensitive telecommunications equipment to Iran. The wording in the House bill is similar to a provision of the Sudan Accountability and Divestment Act of 2007, under which persons contracting with the government are required to certify that they do not engage in certain business activities in Sudan.

Under either bill, the president would retain the authority granted under the ISA to penalize persons investing in Iran in a manner that directly and significantly contributes to Iran’s ability to develop its petroleum resources.

Waiver authority

The House bill seeks to tighten the ISA to force the president to investigate Iran-related business activities, designate persons who have engaged in any of the

disfavored activities described in the ISA and impose penalties on those persons. The executive branch of the US government has long opposed this sort of mandatory language in any legislation, pointing out that it may constitute unconstitutional interference in the president’s plenary foreign affairs authority and in any event could constrain his range of options for achieving foreign policy objectives, including by alienating potential allies in seeking multilateral sanctions.² As a result, it is possible this language will be removed from the final compromise version of the legislation.

Since last fall, while the sanctions bills have been pending, many members of Congress have vocally urged President Obama to begin exercising his existing ISA authority to sanction non-US companies active in Iran’s petroleum sector. In October 2009 a bipartisan group of 50 members of Congress wrote to President Obama to urge ISA enforcement against a list of companies that appear to have made such significant investments in Iran. Senior administration officials were pressed on this request during subsequent committee hearings and in March 2010 a separate bill was introduced that seeks to compel the president to enforce the ISA.

Available sanctions

As noted above, ISA sanctions are available for any person, whether or not they have any ties to the United States. Both the House and Senate bills would clarify that the definition of “person” includes a US or non-US natural person; a corporation, business association, partnership, society or trust; a financial institution, insurer or reinsurer, underwriter or guarantor; any non-US subsidiary, parent or affiliate of any of the aforementioned; and a governmental entity operating as a business enterprise (eg an export credit agency).

Under the current form of the ISA, in imposing sanctions, the president must choose at least two from a “menu” of six sanctions:

- denial of assistance from the US Export-Import Bank;
- denial of licenses to export from the United States;

² The imposition of ISA sanctions on EU-based companies could violate 1997 and 1998 understandings between the US and EU relating to the ISA and other US “extraterritorial legislation”. Reportedly, the EU high representative for foreign affairs has raised this issue in a letter to Secretary of State Clinton.

¹ The provision of products and support to Iran with a dollar value below certain levels would not trigger sanctions.

- denial of loans or credits from any US financial institution exceeding \$10m in one year;
- for financial institutions, denial of Federal Reserve primary dealer status or denial of US government funds repository status;
- denial of participation in federal contracting; and
- denial of the ability to import goods and services to the United States.

Both bills seek to require the president to impose three mandatory sanctions on any person that he determines has engaged in any disfavored activity that the bills add to the ISA. It appears these sanctions would include the blocking (freezing) of all assets of the targeted persons within the United States or within the control of US persons, and would prohibit financial and foreign exchange transactions by the targeted person through the United States or US persons. These sanctions could have the consequence of effectively cutting the targeted person off from the US financial system, and broadly prohibiting transactions by US persons with that person.

The Senate bill also includes provisions authorizing the president to impose sanctions on any US person (including business entities organized under the law of a US state or federal district) that establishes a subsidiary outside the United States “for the purpose of circumventing” the US trade embargo against Iran.

Divestment initiative

The Senate bill would also authorize US state and local governments to divest their assets³ from an entity that invests in, or facilitates investment in, Iran’s energy sector. Under this provision, divestment is authorized from any entity that invests \$20m or more in the Iranian energy sector and from any financial institution that extends \$20m or more to finance an investment in the Iranian energy sector.

Divestment measures must follow certain procedural requirements. The state or local government must make its determination that an entity invests in Iran based on credible, publicly available information. It must then

provide written notice and an opportunity for hearing to the entity from which it proposes to divest. Numerous companies based outside the United States have already received similar notices, or have otherwise learned they are targeted for divestment. If an entity demonstrates that it does not engage in investment activities in Iran, the state or local government should not divest from that entity.

EU blocking regulation

Non-US persons resident in, or incorporated in, the European Community should consider the effect of Regulation No. 2271/96 (the EU Blocking Regulation) on the implementation of any expansion of the ISA. This Regulation prohibits certain natural persons resident in the European Community, and certain legal persons incorporated within the Community, from complying with the ISA (or certain other US sanctions, including those in place against Cuba). More specifically, these persons are prohibited from complying “directly or through a subsidiary or other intermediary”, “actively or by deliberate omission”, with any requirement or prohibition, including requests of foreign courts, “based on or resulting, directly or indirectly, from” the ISA.

Ex-Im bank financing restrictions

Unrelated language in the 2010 Consolidated Appropriations Act, which was signed into law in December 2009, may restrict the ability of non-US persons involved with the Iranian energy sector to participate in US Export-Import Bank (Ex-Im Bank) programs. Subject to certain waiver authorities, during the current federal fiscal year the legislation restricts Ex-Im Bank from providing “any new guarantee, insurance, or extension of credit for any project controlled by an energy producer or refiner” that provides to Iran, contributes to Iran’s capability to import, or assists Iran in its domestic production of refined petroleum resources.

In March 2010 Ex-Im Bank proposed to implement this provision by requiring companies seeking to benefit from its programs to complete a questionnaire relating to Iran. Depending on how Ex-Im Bank interprets the proposed regulations and uses the responses received from the

³ Such assets include state and local government retirement and pension plans, but exclude employee benefit plans covered by Title I of the Employee Retirement Income Security Act of 1974 (ERISA).

questionnaire, many non-US companies with involvement with the Iranian energy sector may find the Consolidated Appropriations Act language to be a hurdle to their participating in Ex-Im Bank programs.

Proposed multilateral sanctions

Since late last year, the Obama Administration has been seeking to build support within the United Nations Security Council (UNSC) for a significant tightening of multilateral sanctions against Iran. In March 2010 there were reports that these efforts had resulted in advanced drafts for a new UNSC resolution and that Russia and China, the final two permanent UNSC members opposing broadened sanctions, might be persuaded to agree.

By early April, it appeared that agreement might be reached on a set of measures that, although less broad than those initially sought by the United States, could significantly restrict trade with Iran in several areas. Reportedly, these could include a multilateral arms embargo, broader freezing of Iranian government (or Revolutionary Guard) assets, binding restrictions on providing certain financial services to Iran and broader enforcement of the existing embargo on providing sensitive goods and services to Iran.

Conclusion

New Iran sanctions would have implications across a range of business sectors. Congress would make clear its intent to cripple the Iranian energy sector by sanctioning persons involved in multiple aspects of Iran's petroleum and petroleum refining industry. Congress would also indicate it will not tolerate US companies that use a foreign subsidiary to circumvent US law. Moreover, publicly traded non-US entities whose investors include US state and local governments may be subject to a broadening array of divestment measures. These measures may carry risk of reputational harm.

Financial institutions, insurance and reinsurance companies, petroleum sector firms, shipping lines and a range of other multinational corporations may wish to scrutinize more closely their business activities that involve contact with Iran or the Iranian government. Any new

Iran sanctions regime may require companies, many of which have never contemplated their business with Iran as raising compliance risks under US law, to consider the possibility of penalties imposed under a newly expanded Iran Sanctions Act.

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