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Client Alert

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Expanding US Sanctions Against Iran Present Growing Risks and Challenges for US and Non-US Companies

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In response to mounting concerns about Iran's nuclear ambitions, the United States Government has recently implemented a number of broad, extraterritorial sanctions targeting two related pressure points: Iran's petroleum and petrochemical industry as well as Iran's connection to global financial markets. Iran's energy sector is widely viewed as the regime's financial lifeline, and the "potential connection between Iran's revenues derived from its energy sector and the funding of Iran's proliferation-sensitive nuclear activities" was recognized in United Nations Security Council Resolution 1929.

The new US sanctions, and additional sanctions legislation being considered on Capitol Hill, create significant challenges and risks for companies inside and outside the United States because of their broad extraterritorial reach and robust government enforcement. This Client Alert reviews the most significant measures in the past 100 days, including:

- The **November 2011** Executive Order issued by President Obama, expanding the scope of sanctionable activity relating to energy-sector activities in Iran;
- The **December 2011** implementation of Iran-related provisions of the National Defense Authorization Act (NDAA), which imposes additional financial-sector sanctions on Iran;
- The **January 2012** designation of Iran's third largest bank by the US Treasury Department's Office of Foreign Assets Control (OFAC);
- The **February 2012** Executive Order issued by President Obama, blocking property owned or controlled by the Government of Iran, the Central Bank of Iran, and Iranian financial institutions;
- The **February 2012** amendments to and reissuance of the Iranian Financial Sanctions Regulations (IFSR) to implement provisions of the NDAA that require the imposition of sanctions with respect to the Central Bank of Iran and designated Iranian financial institutions; and
- **Proposed legislation** in the US Senate (S. 2101) that would expand existing US sanctions in a number of respects, including by compelling disclosures to the US Securities and Exchange Commission of certain Iran-related activities as well as penalizing US companies for business activities by their offshore subsidiaries with Iran.

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Additional US Sanctions Targeting Iran's Energy Sector

On November 21, 2011, President Obama issued Executive Order 13590, which expands the scope of sanctionable activity under the Iran Sanctions Act (ISA), as amended by the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (CISADA). By way of background, the ISA (as amended by CISADA) requires the President – subject to limited Presidential waiver authority – to impose a range of sanctions against parties engaged in certain activities in Iran's energy sector. The potential targets of ISA/CISADA's sanctions are essentially non-US parties, as US persons and companies have been subject to a total US embargo against Iran since 1995, expressed principally through the Iranian Transactions Regulations (ITR).

ISA/CISADA sanctions target parties that (1) make investments above certain monetary thresholds that directly or significantly contributes to the enhancement of Iran's ability to develop petroleum resources; (2) supply goods, services, technology, information, or support above certain monetary thresholds that could (i) directly and significantly facilitate the maintenance or expansion of Iran's domestic production of refined petroleum products (*i.e.*, diesel, gasoline, jet fuel, and aviation gasoline) or (ii) directly and significantly contribute to the enhancement of Iran's ability to import refined petroleum products; and (3) sell or provide to Iran refined petroleum products with a fair market value of $1 million or more, or with an aggregate value of $5 million or more during a 12-month period.

In his message to Congress issued with Executive Order 13590, the President explained that Iran's development of petroleum resources and production of petrochemicals are "two sectors that continue to fund Iran's illicit nuclear activities and that could serve as conduits for Iran to obtain proliferation sensitive technology. Because CISADA has impeded Iran's ability to develop its domestic refining capacity, Iran has tried to compensate by using its petrochemical facilities to refine petroleum."

Building on the ISA/CISADA framework, Executive Order 13590 broadens the reach of the United States' extraterritorial energy-sector sanctions against Iran to include trade activities beyond those involving refined petroleum products. The Executive Order authorizes the State Department, in consultation with other US agencies, to impose sanctions on any party that knowingly sells, leases, or provides to Iran goods, services, technology, or support:

- that has a fair market value of $1 million or more (or an aggregate value of $5 million or more during a 12-month period) that could directly and significantly contribute to the enhancement of Iran's ability to develop petroleum resources (*i.e.*, petroleum, oil, natural gas, liquefied natural gas and refined petroleum products); or
- that has a fair market value of $250,000 or more (or an aggregate value of $1 million or more during a 12-month period) that could directly and significantly facilitate the maintenance or expansion of Iran's petrochemical products (*i.e.*, any aromatic, olefin, and synthesis gas, and any of their derivatives, including ethylene, propylene, butadiene, benzene, toluene, xylene, ammonia, methanol, and urea).

In a Fact Sheet released in connection with Executive Order 13590, which has been updated over time, the State Department clarified that (a) the Executive Order "would not cover the purchase of petroleum resources or petrochemical products from Iran, or the

shipping of those products from Iran, absent other sanctionable conduct," and (b) "the completion of existing contracts is not sanctionable" under the Executive Order but "any contracts that are expanded, renewed, or amended [on or after November 21, 2011] could trigger sanctions."

Parties designated by the State Department under Executive Order 13590 are potentially subject to one or more of the following nine ISA/CISADA sanctions:

1. Denial of Export-Import Bank guarantees, insurance, extensions of credit, or participation in extensions of credit;
2. Denial of licensing or other authorization issued by the United States Government for exports or reexports of US-regulated goods, software, or technology;
3. For financial institutions, (a) such actions as the Chairman of the Board of Governors of the Federal Reserve System and the President of the Federal Reserve Bank of New York deem appropriate, including denying designation, or terminating the continuation of any prior designation as a primary dealer in US government debt instruments; or (b) a prohibition against serving as an agent of the US government or serving as a repository for US government funds;
4. Prohibition on US government procurement or contracting for any goods or services;
5. Prohibition on US financial institutions making loans or providing credits totaling more than $10 million in any 12-month period unless related to humanitarian activities;
6. Prohibition against any transactions in foreign exchange that are subject to the jurisdiction of the United States;
7. Prohibition on 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 the jurisdiction of the United States;
8. Blocking of all property and interests in property that are in the United States, that come within the United States, or that are or come within the possession or control of any United States person; or
9. Restrictions or prohibitions against imports of goods, technology, or services, directly or indirectly, into the United States.

Restricting Iran's Connections to Global Financial Markets

Designation of Iran as a Jurisdiction of Primary Money Laundering Concern

Effective November 25, 2011, the Treasury Department, through its Financial Crimes Enforcement Network (FinCEN), designated Iran a jurisdiction of primary money laundering concern under Section 311 of the USA PATRIOT Act. This designation reaches Iran's entire financial sector, including the Central Bank of Iran, private Iranian banks, and branches, and subsidiaries of Iranian banks operating outside of Iran. Although the existing US sanctions against Iran already prohibit US financial institutions from engaging in both direct and indirect transactions with Iranian banks, the designation under Section 311 requires US financial institutions to implement additional due diligence measures to prevent indirect access by Iranian banks to US correspondent accounts. These additional due diligence measures were identified in a Notice of Proposed Rule Making published on November 28, 2011. The comment period closed in late January 2012.

National Defense Authorization Act

On December 31, 2011, President Obama signed into law the National Defense Authorization Act (NDAA). The NDAA allocates defense funding for Fiscal Year 2012, but it also includes certain Iran-related provisions entitled "Imposition of Sanctions with Respect to the Financial Sector of Iran."

- One provision (Section 1245(b)) requires the President to designate Iran's entire financial sector a primary money laundering concern. As explained above, this designation had already become effective at the end of November 2011.
- A separate provision (Section 1245(c)) requires the President to block all property and interests in property of any Iranian financial institution that is within the United States or within the possession of US persons, and to prohibit all transactions by US persons with such property. As discussed below, the President acted swiftly to implement this provision, issuing Executive Order 13599, which became effective on February 6, 2012.
- Section 1245(d) of the NDAA is potentially the most significant. This provision requires the President – 60 days after enactment of the NDAA – to prohibit or impose "strict conditions" on the ability of foreign financial institutions to maintain a correspondent account or a payable-through account in the United States if the President has determined that the foreign financial institution "has knowingly conducted or facilitated any significant financial transaction with the Central Bank of Iran or another Iranian financial institution designated" on OFAC's list of Specially Designated Nationals (SDN List). Section 1245 also authorizes – but does not require – the President to impose sanctions directly against the Central Bank of Iran.
  - Section 1245(d) includes a number of significant limitations and exceptions. For instance, government-owned or -controlled foreign financial institutions, such as foreign central banks, are sanctionable only if they conduct, or facilitate, "[a] transaction for the sale or purchase of petroleum or petroleum to or from Iran" on or after June 28, 2012 (180 days after the NDAA's enactment). In addition, with respect to all foreign financial institutions, sanctions cannot be imposed in connection with the purchase of petroleum or petroleum products from Iran unless the President first makes a determination "that there is a sufficient supply of petroleum and petroleum products from countries other than Iran to permit a significant reduction in the volume of petroleum and petroleum products purchased from Iran by or through foreign financial institutions." Section 1245(d) also does not reach transactions for the sale of food, medicine, or medical devices to Iran and, most notably, gives the President a renewal 120-day national security interest waiver.
  - On February 14, 2012, OFAC issued guidance clarifying a number of issues relating to the implementation of the NDAA, and, as discussed below, the agency recently reissued the IFSR to implement provisions of the NDAA that require the imposition of sanctions with respect to the Central Bank of Iran and designated Iranian financial institutions. Notably, the February 14 guidance explains that OFAC would consider the following to constitute "significant financial transactions" under Section 1245(d) of the NDAA: (a) barter trades – involving oil-for-debt payments, for instance – by foreign financial

institutions with the Central Bank of Iran or designated Iranian banks, (b) the passive holding of Central Bank of Iran reserves in certain cases, and (c) the provision of trade finance and/or letter of credit services. OFAC also stated that "no general exception will be provided for payments arising out of pre-existing contracts."

OFAC Amends and Reissues the IFSR to implement NDAA Provisions

On February 27, 2012, OFAC amended and reissued in their entirety the IFSR to implement Section 1245(d) of the NDAA. Notably, it took the agency less than two months to amend and reissue the IFSR. This aggressive timeline was effectively mandated by Section 1245(d), described above, which requires that the President implement such action within 60 days after enactment of the NDAA. OFAC also issued a Fact Sheet to accompany the new regulatory changes.

Certain key provisions of the amended IFSR include the following:

- Once a foreign financial institution has been designated by the Secretary of the Treasury as having knowingly conducted or facilitated a significant financial transaction with the Central Bank of Iran or an Iranian financial institution on the SDN List, Section 561.203 of the IFSR prohibits US financial institutions from opening, and prohibits or imposes strict conditions on their maintaining, a correspondent account or a payable-through account in the United States for the designated foreign financial institution. OFAC will identify designated foreign financial institutions on a "List of Foreign Financial Institutions Subject to Part 561" that will be maintained on the Iran Sanctions page of the OFAC website and also published in the Federal Register. Section 560.204 gives a US financial institution a 10-day window to wind down and close a correspondent or payable-through account maintained for a designated foreign financial institution. The US financial institution is also required to submit a report to OFAC within 30 days of closing the account.
- Short of requiring that a pre-existing correspondent account or payable-through account be closed, the Treasury Department could impose "strict conditions" on the maintenance of such accounts by US financial institutions. These "strict conditions" could include prohibiting or restricting the provision of trade finance through the account; restricting to certain types the transactions that can be processed through the account, such as personal remittances; placing monetary or volume limits on the transactions that can be processed through the account; requiring the US bank's pre-approval for all transactions processed through the account; and prohibiting or restricting the processing of foreign exchange transactions through the account.
- The Treasury Department will look to a number of factors in making a determination that a foreign financial institution has engaged in a "significant financial transaction" with the Central Bank of Iran or another Iranian financial institution" designated on the SDN List. These factors "may" include some or all of the following:
  1. the size, number and frequency of the transactions performed over a period of time, including whether transactions are increasing or decreasing as well as the rate of increase or decrease;
  2. the nature of the transactions, including their type, complexity and commercial purpose;
  3. the level of awareness, involvement or approval by management and

whether the transactions are part of a pattern of conduct or the result of a business development strategy;

4. the proximity between the foreign financial institution conducting or facilitating the financial transaction and the Central Bank of Iran or a designated Iranian financial institution (*e.g.*, a direct customer relationship generally would be of greater significance);

5. the impact of the transactions on the objectives of CISADA or the NDAA, including the benefit conferred; whether and how the transactions contribute to the proliferation of weapons of mass destruction, support for international terrorism, the suppression of human rights, an increase in Iran's crude oil revenues, or connecting the Central Bank of Iran or a designated Iranian bank to the international financial system; and whether the transactions support humanitarian activity or involve the payment of UN-approved expenses or purchases of food, medicine, or medical devices.

6. whether the transactions involve an attempt to obscure or conceal the actual parties or true nature of the transactions or to evade sanctions; and

7. whether the transactions involve other factors, such as the passive holding of Central Bank of Iran reserves; the Central Bank of Iran's limited role to providing settlement services of foreign currency exchanges between a non-designated Iranian bank and a foreign financial institution; and whether the transactions involve only the repayment of official development assistance or the transfer of funds required as a condition of Iran's membership in an international financial institution.

Blocking Property of the Government of Iran and Iranian Financial Institutions

Following through on Section 1245(c) of the NDAA, on February 5, 2012, the President issued Executive Order 13599, blocking (*i.e.*, freezing) all property and interests in property of the Government of Iran, including the Central Bank of Iran, that are in the United States or are within the possession of control of a US person. The Executive Order also freezes the property and interests in property of any "Iranian financial institution," defined to include "a financial institution organized under the laws of Iran or any jurisdiction within Iran (including foreign branches), any financial institution in Iran, any financial institution, wherever located, owned or controlled by the Government of Iran . . . ."

Prior to this Executive Order, US financial institutions were generally required to "reject" (rather than freeze) transactions involving the Government of Iran or its owned or controlled entities. Executive Order 13599 became effective on February 6, 2012.

In connection with Executive Order 13599, OFAC issued two general licenses that authorize limited transactions with Iran, and the agency also released Frequently Asked Questions relating to the new Executive Order.

- General License A authorizes virtually all transactions with the Government of Iran or Iranian financial institutions that are permitted under general licenses set forth in the Iranian Transactions Regulations, such as the general license authorizing US persons to protect certain intellectual property rights in Iran (31 C.F.R. § 560.509). General License A also permits transactions pursuant to the terms of specific licenses issued by OFAC, such as licenses for sale and export of agricultural commodities, medicines, and medical devices issued

pursuant to the Trade Sanctions Reform and Export Enhancement Act (TSRA). If a specific OFAC license does not have an expiration date, the license is valid until April 6, 2012.

- General License B authorizes US depository institutions and registered brokers and dealers in securities to process most noncommercial, personal remittances to or from Iran, including for or on behalf of individuals ordinarily resident in Iran, provided they are not included within the term "Government of Iran," as defined in the Executive Order, or otherwise blocked under other OFAC sanctions programs.

Designation of Bank Tejarat and Other Financial Institutions

On January 23, 2012, OFAC added Iran's third-largest bank, Bank Tejarat, to the SDN List pursuant to Executive Order 13382 (Blocking Property of WMD Proliferators and Their Supporters). The Treasury Department explained that Bank Tejarat had provided "financial services to several Iranian banks and firms already subject to international sanctions for their involvement in Iran's weapons of mass destruction (WMD) proliferation activities." OFAC also designated Trade Capital Bank for providing financial services to the Export Development Bank of Iran and for being owned or controlled by Bank Tejarat.

Bank Tejarat and Trade Capital Bank joined 23 financial institutions, including all of Iran's largest state-owned banks, on the SDN List. The Treasury Department simultaneously issued a Fact Sheet listing Iranian-linked financial institutions designed pursuant to Executive Order 13382 and Executive Order 13224 (Blocking Property of Persons Who Commit, Threaten to Commit, or Support Terrorism).

Notably, the Treasury Department warned that business dealings by foreign financial institutions with designated Iranian banks could result in sanctions under CISADA because "foreign financial institutions that knowingly facilitate significant transactions or provide significant financial services for an Iranian-linked financial institution designated by the US . . . face the loss of their direct access to the US financial system."

Pending Iran Sanctions Legislation on Capitol Hill

On February 2, 2012, the Senate Banking, Housing, and Urban Affairs Committee approved the Iran Sanctions, Accountability and Human Rights Act of 2012 (S. 2101). The bill was placed on the Senate legislative calendar on February 13, 2012. The bill has broad, bipartisan support, and recent reports suggest that the bill could go to the full Senate for a vote by mid-March (companion legislation has not yet been introduced in the House of Representatives). The Senate bill includes many significant provisions, including the following:

- Section 213, entitled "Liability of Parent Companies for Violations of Sanctions by Foreign Subsidiaries" would close the so-called "loophole" that permits foreign subsidiaries of US companies to trade lawfully with Iran under certain circumstances. The provision would require the President no later than 60 days after the law's signing to "prohibit an entity owned or controlled by a United States person and established or maintained outside the United States from engaging in any transaction directly or indirectly with the Government of Iran or any person subject to the jurisdiction of that Government that would be prohibited . . . if the transaction were engaged in by a United States person or in the United States." To avoid penalties under the International Emergency Economic Powers Action (IEEPA), the US entity would have 180 days to "divest" or

"terminate" its business with the foreign subsidiary. If enacted, this provision would significantly expand the extraterritorial reach of the Iranian Transactions Regulations.

- Section 214, entitled "Disclosures to the Securities and Exchange Commission relating to Sanctionable Activities" would require all companies (US and non-US) whose stock is traded on a US exchange to disclose to the SEC in annual or quarterly reports if the company or any affiliate has knowingly engaged in certain Iran-related activities. Among others, these activities include engaging in conduct sanctionable under ISA/CISADA as well as engaging in any transaction or dealing with parties designated under executive orders relating to WMD proliferation and terrorism. Significantly, a disclosure would also be triggered by any transaction or dealing with the Government of Iran or any agency or entity owned, controlled, or acting on behalf of the Government of Iran. The disclosure to the SEC would require "a detailed description of each such activity," including the nature and extent of the activities; the gross revenues and net profits attributable to the activities; and whether the activity will be continued. This SEC reporting provision would apply to any annual or quarterly report required to be filed with the SEC 180 days after enactment of the legislation.

- Section 216 of the Senate bill is addressed to "global financial communications services providers," and in particular the Society for Worldwide Interbank Financial Telecommunication (SWIFT), that links banks around the world – including Iranian banks – through a common and secure financial messaging system. This provision would authorize, but not require, the President to impose IEEPA-based sanctions on a communications services provider, its directors and significant shareholders, that provide financial communication services to the Central Bank of Iran or designated Iranian banks. Because SWIFT is a cooperative owned by member financial institutions, the sanctions could in theory be imposed against any member.

- Section 201 would extend ISA/CISADA sanctions to any party that knowingly participates in an energy-related joint venture *outside of Iran*, where the Government of Iran is a substantial partner or investor, or where Iran could, through a direct operational role in the venture or "by other means" receive know-how or equipment not previously available to Iran that could directly and significantly contribute to the enhancement of Iran's ability to develop petroleum resources in Iran.

If you have any questions about this *Client Alert* or the potential application of these or other sanctions, please contact one of the authors listed below or the Latham attorney with whom you normally consult:

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