Sanctions Update: New Measures Target Non-U.S. Business with Iran

U.S. companies can no longer distance themselves from business conducted by their foreign subsidiaries with Iran. On August 10, 2012, President Obama signed into law the Iran Threat Reduction and Syria Human Rights Act of 2012 ("the Act"). The Act expands existing sanctions, for example those under the Iran Sanctions Act of 1996 ("ISA"), as amended by the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 ("CISADA"), and creates additional sanctions measures against Iran. The Act's broadest impact arguably is the expanded liability imposed on U.S. companies for activities related to Iran of any foreign affiliate *owned or controlled* by the U.S. company. In addition, the law creates new reporting requirements for securities issuers related to Iran business.

The Act increases the extraterritorial reach of U.S. sanctions in many ways, reflecting the U.S. government's determination to disrupt non-U.S. business activities benefitting Iran, as well as Iran's efforts to develop weapons of mass destruction ("WMD") and violate the human rights of its people. The Act complements other expansive U.S. actions targeting extraterritorial activity, such as the recently authorized sanctions further restricting the actions of non-U.S. financial institutions, and the U.S. Department of the Treasury's sanctions on two non-U.S. financial institutions under CISADA.

Non-U.S. multinationals are increasingly in need of evaluating the potential effect of U.S. sanctions on any business relating to Iran. The number of ways in which these sanctions can reach non-U.S. business engagements with Iran has broadened significantly. Companies with any business related to Iran should consider how the Act impacts their operations and monitor the new law's implementation.

I. Closing the "Foreign Subsidiary Loophole": Iran Sanctions to Apply to Foreign Subsidiaries

U.S. companies with foreign subsidiaries or in some cases other foreign affiliates with business related to Iran are now potentially liable and subject to U.S. sanctions. All such U.S. businesses should be evaluating and taking action to prevent such liability from attaching, which likely will involve significant business impact. For example, the law provides in effect a brief period for ending any Iranian business and a further period for divestment of the foreign subsidiary that is engaged with Iran. There is not currently any grandfathering of existing contracts, so that companies are faced with choices relating to breaking contracts with civil law repercussions and/or divesting foreign affiliates. To date, no implementing regulations or guidance has been issued related to the Act, which potentially could address grandfathering and other practical implementation issues confronting global companies, as has been the case for some other Iran sanctions.

Section 218 of the Act prohibits foreign subsidiaries or any foreign entity "owned or controlled by" U.S. companies from "knowingly engaging in any transaction directly or indirectly" with the Government of Iran ("GOI") or any person subject to its jurisdiction, if the transaction would be prohibited pursuant to the International Emergency Economic Powers Act ("IEEPA") if engaged in by a U.S. person or in the United States. IEEPA is the primary statutory basis for the broad prohibitions on U.S. business dealings with Iran. U.S. persons generally include any U.S. citizen wherever located, U.S. business enterprise, including any non-U.S. branch, and any person or entity located in the United States.

The Act defines U.S. ownership or control of a foreign entity as: (i) economic ownership of more than 50 percent of the equity interest by vote or value in a foreign entity, (ii) holding a majority of board seats of the foreign entity, or (iii) the ability "to otherwise control the actions, policy, or personnel decisions of the entity." Implementation of the latter prong is uncertain and has the potential to be interpreted broadly, leaving in addition to U.S. parent companies many other U.S. companies with foreign affiliates engaged with Iran potentially subject to sanctions.

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This provision underscores the ever-increasing extraterritorial reach of U.S. sanctions targeting Iran. Prior to enactment of the Act, where activity related to Iran took place outside of the United States and did not involve directly or indirectly any U.S. persons, foreign subsidiaries of U.S. companies were not subject to many of the sanctions imposed on U.S. persons, and U.S. companies were not necessarily liable for the acts of their foreign affiliates related to business with Iran.

The law requires the President to implement Section 218 no later than 60 days after the effective date of the Act, i.e., October 9, 2012, and provides that enforcement will not take place where a U.S. company divests or terminates its business with the foreign entity engaged with Iran within 180 days after the effective date of the Act, or by February 6, 2013.

II. Requiring Disclosure to the SEC

Section 219 amends the Securities Exchange Act of 1934 to require securities issuers to disclose in detail in their quarterly and annual reports to the SEC if they have engaged in sanctionable activity under ISA, CISADA, or with persons whose property and interest in property have been blocked under certain Executive Orders or who are identified pursuant to OFAC regulations as the GOI. If there is such a disclosure, the issuer is also required to file a notice with the SEC about the disclosure. The SEC is then required to transmit the report to the President and Congress, and the President must then initiate an investigation and determine within 180 days whether sanctions should be imposed in connection with the disclosed activities.

III. Expanding ISA and other Iran Energy Sector Sanctions

A. Additional Sanctionable Activity

Section 201 of the Act generally codifies E.O. 13590, which prohibits the provision of goods, services, technology, or support that could "directly and significantly" help Iran maintain or enhance its ability to develop petroleum resources, or produce refined petroleum or petrochemical products above certain monetary thresholds. As it relates to developing petroleum resources or producing refined petroleum products, the monetary threshold is $1,000,000 or more, or $5,000,000 or more over 12 months. For producing petrochemical products, the monetary threshold is $250,000 or more, or $1,000,000 or more over 12 months.

Section 201 furthermore amends ISA to specify that sanctionable investment includes "infrastructure" primarily used for the delivery of refined petroleum products and prohibit joint ventures established on or after January 1, 2002, for the development of petroleum resources outside Iran, if the GOI is a "substantial partner or investor," or Iran could obtain new "technological knowledge or equipment."

Section 202 creates new sanctions regarding the transportation of crude oil from Iran and the evasion of sanctions by shipping companies, including activities such as concealing the Iranian origin of crude oil and refined petroleum products.

B. ISA Sanctions Expanded

Section 204 expands the available ISA sanctions to include: 1) prohibiting U.S. persons from investing in or purchasing significant amounts of equity or debt instruments from sanctioned persons; 2) denying admission into the United States to a foreign corporate officer, principal, or controlling shareholder of a sanctioned company; and 3) imposing sanctions not only on the sanctioned company, but on its principal executive officers. In addition, section 201 increases the minimum number of required sanctions that the President must impose as prescribed by the law from three to five. The President's ability to waive sanctions is further limited, including eliminating any permanent waiver to a one-year renewable waiver.

C. New Definitions

Section 207 adds definitions to ISA. Under ISA, the President is required to investigate upon "credible information" that a person is engaging in sanctionable activity; but ISA did not have a definition of "credible information." Under the new definition, "credible information" includes public announcements and reports to stockholders. At the President's discretion, it may also be interpreted to include an announcement by the GOI or a specified U.S. governmental agency or "similarly reputable" organization that the person has engaged in sanctionable activity.

The addition of a definition for "services" is also significant, which explicitly extends the reach of ISA sanctions to those providing "software, hardware, financial, professional consulting, engineering, and specialized energy information services, energy-related technical assistance, and maintenance and repairs" in the context of the sanctionable activity under ISA.

IV. Further Targeting Iran's Development of WMD

Section 203 expands the sanctions relating to Iran's ability to develop WMD, prohibiting, among other things, joint ventures relating to the mining, production, or transportation of uranium. In a similar vein, section 211 requires the President to block the property of persons who knowingly provide shipping services, including insurance, to transport goods to or from Iran that could "materially contribute" to Iran's efforts to develop WMD or commit acts of terrorism. Parent companies can be sanctioned if they knew or should have known of the sanctionable conduct, and any affiliate can be sanctioned that knowingly participates in the conduct.

V. Government of Iran and IRGC

Section 217 mandates that various sanctions such as the Executive Order blocking the property and interest from property of the GOI and the Central Bank of Iran (CBI) continue until the President certifies the GOI and CBI have ceased to support international terrorism and proliferation of WMD. Title III of the Act addresses sanctions targeting Iran's Revolutionary Guard Corps ("IRGC"). For instance, Section 301 requires the President to identify foreign persons that are officials, agents, or affiliates of IRGC, designate such persons for sanctions if they are not already designated, and block their property and interests in property. Section 311 requires all prospective U.S. government contractors to certify that they have not knowingly engaged in significant transactions with IRGC or any of its affiliates.

VI. Exposition of CISADA targeting non-U.S. financial institutions

Sections 214, 215, and 216 modify section 104 of CISADA, which generally addresses mandatory sanctions with respect to financial institutions that engage in certain transactions. Section 104(c) of CISADA prohibits the opening or maintaining in the United States of a correspondent account or a payable-through account by a foreign financial institution that the Secretary of the Treasury finds knowingly engages in certain specified activities. Such activities include facilitating significant transactions or providing significant financial services for Iran's Revolutionary Guard Corps ("IRGC") or financial institutions designated under the WMD or terrorism sanctions programs, and facilitating the activities of persons subject to financial sanctions pursuant to specified UN Security Council resolutions. The new law expands the scope of § 104(c) to include the subsidiaries and, in some cases, agents and any persons, not just foreign financial institutions, that otherwise facilitate such activities.

VII. Targeting Human Rights Abuses in Iran and Syria

Titles IV and VII of the Act create additional sanctions with regard to human rights abuses in Iran and Syria, addressing: 1) certain persons who are responsible for or complicit in human rights abuses; 2) the transfer of goods or technologies to Iran that are likely to be used to commit human rights abuses; and 3) persons who engage in censorship or other related activities against the citizens of Iran or Syria. Executive Order 13606 of April 23, 2012, already imposes sanctions on certain persons engaged in human rights abuses by these governments.

VIII. Additional Sanctions Measures

A. Specialized Financial Messaging Services

Section 220 creates new sanctions for persons who "knowingly and directly" provide, or "knowingly enable or facilitate direct or indirect access" to, specialized financial messaging services for Iranian financial institutions designated under CISADA. Members of the U.S. Congress previously had expressed their desire to prohibit Iranian financial institution transactions through the SWIFT financial messaging system, which leads in such messaging services and had already announced in March 2012 that, pursuant to European Union (EU) law, it would discontinue communications services to Iranian financial services that are subject to EU sanctions.

B. Iranian Sovereign Debt

Section 213 creates new sanctions for persons who knowingly purchase, subscribe to, or facilitate the issuance of sovereign debt of the GOI or any related entities.

C. National Iranian Oil Company & National Iranian Tanker Company

Section 212 creates new sanctions for persons who knowingly provide underwriting services, insurance, or reinsurance to the National Iranian Oil Company ("NIOC") or the National Iranian Tanker Company ("NITC"). There is an exception for persons who exercise "due diligence" to ensure that they do not provide services to these companies.

In conjunction with the other sanctions targeting

IRGC, Section 312 requires the Secretary of the Treasury to determine whether NIOC and/or NITC are agents or affiliates of IRGC, with any sanctions imposed accordingly. Sanctions applied to the purchase of petroleum or petroleum products from NIOC or NITC depend on whether the President determines there is "sufficient supply" and whether a country is significantly reducing its petroleum or petroleum product purchases from Iran.

D. Other Provisions

The Act also contains additional provisions, including: denying visas to citizens of Iran seeking education in the United States related to energy or nuclear science or engineering; using blocked assets in the United States to pay for specific court judgments; modifying the National Defense Authorization Act; and requiring additional reports to Congress on certain activities related to Iran.

IX. New Foreign Financial Institution Sanctions Imposed by Executive Order and U.S. Department of the Treasury Actions

Executive Order 13622 of July 31, 2012, authorizes the imposition of financial sanctions on foreign financial institutions found to have knowingly conducted or facilitated any significant financial transactions: 1) with NIOC or Naftiran Intertrade Company ("NICO"); 2) for the purchase or acquisition of petroleum or petroleum products from Iran; or 3) for the purchase or acquisition of petrochemical products from Iran. In addition, the E.O. authorizes the Treasury to block the property and interests in property of any person determined to have materially assisted, sponsored, or provided financial, material, or technological support for, or goods or services in support of, NIOC, NICO, or the Central Bank of Iran, or the purchase or acquisition of U.S. bank notes or precious metals by the GOI.

The U.S. Treasury Department's Office of Foreign Assets Control ("OFAC") also announced the imposition of sanctions under CISADA against two foreign financial institutions for knowingly facilitating significant transactions or providing significant financial services for designated Iranian banks. According to OFAC, China's Bank of Kunlun and Iraq's Elaf Islamic Bank facilitate the movement of millions of dollars worth of international transactions to Iranian banks designated for their connection to Iran's WMD proliferation or support for terrorism for Iran. As a result of the sanctions, financial institutions may not open correspondent or payable-through accounts for Bank of Kunlun or Elaf Islamic Bank in the United States, and any financial institutions that currently hold such accounts must close them within 10 days of the announcement. However, this action does not require the immediate freezing of any assets that Elaf Islamic Bank or Bank of Kunlun may have within U.S. jurisdiction.

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