Sanctions 14 Jul, 2010

The Comprehensive Iran Sanctions, Accountability and Divestment Act of 2010 (CISADA)

The following summary of CISADA, which may be of interest to Members, is reproduced with the kind permission of the international law firm Hogan Lovells. It does not modify the terms of the Club's Notice to Members No. 2 of 2010/2011 and in particular the reminder to Members of the Club's general sanctions policy.

Summary

The Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (CISADA or "the Bill") was passed by Congress on June 24, 2010, with a vote of 99-0 in the Senate and 408-8 in the House of Representatives. The Bill expands upon the restrictions of the Iran Sanctions Act of 1996 (the ISA) and the Iranian Transaction Regulations administered by the Department of Treasury's Office of Foreign Assets Control (OFAC). President Obama signed the Bill on 1 July 2010.

CISADA covers a significantly broader range of areas than the ISA that makes it of particular interest to companies with, or considering business activities related to, Iran. This update describes some of the highlights of the legislation. Chief provisions include:

- **Scope of Activities Covered**: The bill substantially expands sanctionable activities beyond current law so as to include efforts by foreign firms: 1) to sell, lease, or provide to Iran any goods, services, technology, information, or support that would allow Iran to maintain or expand its petroleum refineries; or 2) to supply refined petroleum products to Iran (all applicable to activities above $1 million in value). The effect of the first-referenced provision would be to significantly expand the breadth of the sanctions to potentially include companies in many new sectors, including financial services, telecommunications, logistical, consulting and business services, and any other sector capable of providing support to Iran's petroleum refineries.

- **Sanctions to Be Applied**: Existing law requires the imposition of two out of a menu of six sanctions on a sanctioned entity. The new legislation adds three new sanctions and requires the President to impose three sanctions out of a total of nine. The three new sanctions applicable vis-à-vis sanctioned entities are: 1) a prohibition on foreign exchange transactions subject to U.S. jurisdiction; 2) a prohibition on banking transactions; and 3) a prohibition on transactions involving property of the sanctioned entity.

- **"Directly and Significantly"**: The Bill requires that the sanctionable assistance "directly and significantly" assist Iran in the development of refined petroleum capacity or in obtaining refined petroleum products. This language was in the Senate bill and survived in the final version. The terms "directly and significantly" are not defined in the Bill, so this remains an interpretive issue to be addressed as the law is implemented.

- **Knowledge Requirement**: The Bill requires that any assistance be done "knowingly," which is defined as including both actual knowledge or where the person "should have known, of the conduct, circumstances, or the result."

- **Parents, Subsidiaries, Affiliates**: The Bill expands the general definition of "person" to specifically reference financial institutions, insurers, underwriters, guarantors, and any other business organizations (in addition to entities already covered, such as natural persons, corporations, partnerships, and NGO's). In addition, the Bill confirms the liability of successor entities, parents, affiliates (e.g. sister subsidiaries), and subsidiaries of an entity that engages in sanctionable conduct. The Bill lowers the threshold for parent company liability; "parent" is defined broadly as any entity that owns or controls the acting company. In order for a parent company to be subject to sanctions, the parent must only have had actual knowledge or should have known its subsidiary was engaging in sanctionable activities. This is a significant enhancement of the ISA, which held parent companies liable only if they approved and/or facilitated the prohibited activity. For a subsidiary or affiliate to be subject to sanctions, it must have knowingly engaged in sanctionable activities.

- **Mandatory Investigations**: The Bill strengthens the investigation provision of the ISA by requiring the President to initiate investigations into the possible imposition of sanctions upon receipt of credible information that a person is engaged in sanctionable activities. However, the President need not initiate or may terminate an investigation if the President certifies the subject of the investigation is no longer engaging in the activity at issue, has taken significant steps toward stopping the activity, or has provided assurances that it will not knowingly engage in the activity in the future. Previously, this was an optional provision. In light of only one investigation of a company since the enactment of the ISA, this amendment represents an effort by Congress to bind the President to actively enforce sanctions against companies engaged in sanctionable activities with Iran.

- **Waiver for Cooperating Countries**: The bill provides a waiver, on a case-by-case basis, for companies from countries that are cooperating with the U.S. in multilateral efforts to prevent Iran from: 1) acquiring or developing chemical, biological, or nuclear weapons or related technologies or 2) acquiring or developing destabilizing numbers and types of advanced conventional weapons. The President must state that the waiver is vital to the national security interests of the U.S. and must notify the Congress of the company receiving the waiver. Renewals of waivers are possible under certain conditions. The waiver is to be applied once an individual company has been found to violate the provision, so it is not the blanket exemption for all countries from the cooperating jurisdiction that the Obama Administration had originally sought.

- **Government Procurement**: The Bill contains a provision requiring companies seeking U.S. Government procurement contracts to self-certify that they do not engage in sanctionable activities. This means companies will have to conduct an internal evaluation of their activities under CISADA and determine whether they have violated the law. The Conference Report which accompanied the Bill states that "the contractor will need to certify that the contractor or a person owned or controlled by the contractor does not conduct any activity for which sanctions may be imposed." It further states that the "Conferees believe that exercising control as a parent company over subsidiaries or affiliates should be considered in functional terms, as the ability to exercise certain powers over important matters affecting an entity."

- **Expands Restrictions in the ITR**: The Bill codifies restrictions on exports to Iran and imports from Iran. The Bill also imposes restrictions on subsidiaries of U.S. financial institutions unrelated to the oil and gas sector of Iran.

- **Designation of Destinations of Diversion Control**: The President must designate countries identified as having diverted certain goods, technology, or services to Iran. The Bill would impose licensing restrictions on regulated exports to such designated countries.

- **State and Local Divestment Laws**: The Bill establishes a framework for States to pass divestment laws that prohibit the investment of public funds in companies that invest in Iran.

I. Petroleum-Related Sanctions

1. Prohibited Activities

CISADA imposes sanctions on a number of activities related to petroleum activities. The Bill obliges the President to impose a minimum of three of nine specified sanctions measures against entities under a number of different circumstances. The President must impose at least three sanctions against entities that knowingly:

- Make investments of $20 million or more that directly and significantly contributes to the enhancement of Iran's development (e.g. exploration, extraction, refining, or transportation by pipeline) of its petroleum and natural gas resources;
- Sell, lease, or provide to Iran goods, services, technology, information, or support valued at $1 million or more, or $5 million or more over a 12-month period that could directly and significantly facilitate Iran's domestic production of refined petroleum products (e.g. gasoline, diesel, jet fuel, and aviation gasoline);
- Sell or provide refined petroleum products worth $1 million or more or $5 million or more over a 12-month period; or
- Sell, lease, or provide to Iran goods, services, technology, information, or support valued at $1 million or more, or $5 million or more over a 12-month period that could directly and significantly contribute to Iran's ability to import refined petroleum products (this provision applies to related underwriting, insurance, reinsurance, financing, brokering, and shipping activities).

The term "knowingly", with respect to conduct, a circumstance, or a result, means that a person has actual knowledge, or should have known, of the conduct, the circumstance, or the result. In the context of Iran's domestic production of refined petroleum, the term "support" is defined in reference to the description of "goods, services, technology, information, or support" that could directly and significantly facilitate the maintenance or expansion of Iran's domestic production of refined petroleum products, including any direct and significant assistance with respect to the construction, modernization, or repair of petroleum refineries. In the context of Iran's ability to import refined petroleum products, the term "support" is defined in reference to the description of "goods, services, technology, information, or support" that could directly and significantly contribute to the enhancement of Iran's ability to import refined petroleum products, including (i) underwriting, insurance, and reinsurance services, (ii) financing or brokering services, and (iii) shipping services.

2. Due Diligence Exception for Insurers, Reinsurers, and Underwriters

The prohibition on the provision of services and support that could directly and significantly contribute to the enhancement of Iran's ability to import refined petroleum products applies to underwriting or entering into a contract to provide insurance or reinsurance for the sale, lease, or provision of prohibited goods, services, technology, information, or support. However, CISADA creates an exception for underwriters and insurance providers that the President determines exercised due diligence in establishing and enforcing official policies, procedures, and controls to ensure that the entity at issue does not enter into sanctionable engagements described in this section.

3. Presidential Waiver

Under the ISA, the President had the authority to waive the requirement to impose sanctions if the President determined that it was "important to the national interest of the United States" to do so. Under CISADA, waiver of the required sanctions is authorized only if the President determines and reports to the appropriate congressional committees that it is "necessary to the national interest."

4. Sanctions

Existing law directed the President to impose two sanctions from a menu of six against a company to be sanctioned. The new bill adds three new sanctions, then requires the President to impose three sanctions from the new total menu of nine. The three new sanctions created under this new legislation are:

- Foreign Exchange: Prohibition of foreign exchange transactions subject to U.S. jurisdiction that involve sanctioned entities.

- Banking Transactions: Prohibition on transfers of credit or payments between, by, through, or to financial institutions that are subject to U.S. jurisdiction and that involve any interest of sanctioned entities.

- Property Transactions: Prohibition on transacting (e.g. acquiring, holding, withholding, using, transferring, withdrawing, transporting, importing, or exporting) or exercising any right, power, privilege with respect to property subject to the jurisdiction of the U.S. to which a sanctioned entity has an interest.

The following are the existing six sanctions established under the ISA:

- Denial of Export-Import Bank assistance for exports;

- Denial of U.S. export licenses or other specific permission under the U.S. export control laws;

- Denial of certain loans from U.S. financial institutions;

- Prohibitions on a sanctioned person that is a financial institution, including designation as a primary dealer and as a repository of government funds;

- Ban on U.S. Government procurement of goods and services; and

- Restrictions on imports in accordance with the International Emergency Economic Powers Act.

5. New Certification Requirement for Government Contractors

The Bill requires any prospective U.S. government contractor to self-certify that it does not engage in any of the restricted petroleum-related activities described above. Entities that submit false certification will have their contracts terminated and are subject to debarment for a period of up to three years. There are certain exceptions to the prohibition on executive agencies from entering into procurement contracts with such entities. In addition, the President may on a case-by-case waive the requirement that a person make a certification if the President determines and notifies Congress that doing so is in the national interest of the U.S. Companies will need to monitor the scope of the certification that will be required under the Federal Acquisition Regulations.

CISADA also prohibits executive agencies from entering into procurement contracts with any entity that exports sensitive technology to Iran. The Bill defines sensitive technology as hardware, software, telecommunication equipment, or other equipment used to restrict the flow of unbiased information in Iran or monitor, disrupt, or restrict free speech in Iran.

6. Effective Date

The effective date of the Bill generally is the date of enactment. As such, the Bill's provisions apply prospectively to covered activities. Petroleum-related investments subject to the ISA made prior to the enactment of CISADA remain subject to the ISA as in effect before the passage of CISADA.

There are a number of issues that will need to be addressed by the regulating agency with respect to existing contracts entered into prior to enactment that were not prohibited under the ISA. This is particularly true for issues faced by the insurance and reinsurance industry.

II. Enhancements to Existing Sanctions Against Iran

1. Prohibition on Imports and Exports

The Bill codifies restrictions on the import of Iranian-origin good and services, with limited exceptions such as informational materials. This provision would eliminate the existing regulatory exemptions with respect to certain imports from Iran. The Bill also codifies the prohibition on export of goods, services, and technology from the U.S. or by a U.S. person to Iran.

OFAC will need to review and amend its regulations to address the full impact of these changes, particularly as it relates to re-exports. However, CISADA provides exceptions, or authorizes licenses, for exports of, among other things, food, medicine, humanitarian assistance, aircraft parts and components to ensure safety of flight, information and informational materials, and certain internet-related services, hardware, software, and technology. Further, CISADA provides an exception for exports deemed by the President to be in the national interest of the U.S.

2. Freezing Assets

CISADA imposes a freeze of assets belonging to individuals designated by the President pursuant to the International Emergency Economic Powers Act (IEEPA). The Bill specifically identifies Iranian diplomats, representatives of other government or military or quasi-governmental institutions, such as Iran's Revolutionary Guard Corps (IRGC) and its affiliates, and requires freezing funds and other assets belonging to designated persons, as well as transfers to family members or associates acting on the designated person's behalf. This list of entities is similar to the list of additional entities subject to the Iranian Transactions Regulations published by OFAC in the Federal Register on June 16, 2010 (75 Fed. Reg. 34630).

This provision also requires that financial institutions holding funds or assets belonging to a designated person or funds or assets that person transfers to a family member or associate must report such information to OFAC.

3. Penalties

CISADA applies the penalties provided for in IEEPA to persons who violate, attempt or conspire to violate, or cause a violation of the foregoing provisions. These penalties include civil penalties of up to $250,000 per transaction or twice the amount of the transaction, whichever is greater. Criminal penalties, for willful violations, include a fine of up to $1 million, and/or imprisonment of up to 20 years.

III. New Restrictions on Financial Institutions

The Bill imposes new restrictions on financial institutions that are independent of the petroleum-related sanctions described above. The new restrictions apply to both "domestic" and "foreign" financial institutions, with these terms left to be defined by the Secretary of the Treasury. The penalties under IEEPA apply for violations.

1. Foreign Financial Institutions

CISADA requires the Secretary of the Treasury to promulgate regulations to prohibit or impose strict conditions on the holding of correspondent or a payable-through account in the United States by foreign financial institutions engaged in specified activities. These activities include:

- Facilitating the efforts of the Government of Iran (including efforts of the IRGC or any of its agents or affiliates) to acquire or develop weapons of mass destruction or delivery systems for weapons of mass destruction or to provide support for organizations designated as foreign terrorist organizations or support for acts of international terrorism;
- Facilitating the activities of a person subject to financial sanctions pursuant to United Nations Security Council Resolutions;
- Engaging in money laundering to facilitate the activities described above;
- Facilitating efforts by the Central Bank of Iran or any other Iranian financial institution to carry out activities described in (a) and (b); and
- Facilitating significant transactions or providing significant financial services for the IRGC or any of its agents or affiliates whose property is blocked under IEEPA or for a financial institution whose property is blocked in connection with Iran's weapons activities or support for international terrorism.

2. Domestic Financial Institutions and Entities Owned or Controlled by such Institutions

CISADA requires the Secretary of the Treasury to promulgate regulations to prohibit any entity owned or controlled by a domestic financial institution from knowingly transacting with or benefitting the IRGC or any of its agents or affiliates whose property is blocked under IEEPA. This directly expands the scope of the prohibitions to foreign subsidiaries of U.S. companies.

3. Requirements for Financial Institutions

CISADA requires the Secretary of the Treasury to promulgate regulations to require domestic financial institutions that hold correspondent accounts or payable-through accounts in the U.S. for foreign financial institutions to:

- Perform an audit of activities regulated by the Bill that may be carried out by a foreign financial institution;
- Report to the Department of the Treasury with respect to transactions or other financial services provided with respect to any such activity;
- Certify that the foreign financial institution is not knowingly engaged in any such activity; and / or
- Establish due diligence policies, procedures, and controls to detect whether the Secretary of the Treasury has found the foreign financial institution to knowingly engage in any such activity.

The Secretary of the Treasury may waive the application of the aforementioned provisions to foreign or domestic financial institutions if the Secretary determines and submits a report to the appropriate congressional committees that a waiver is necessary to the national interest of the U.S.

IV. Divestment from Companies Investing in Iran

CISADA sets out criteria for States to prohibit the investment of public funds in any person that invest in Iran. For purposes of this section of the Bill, a "person" includes a parent, subsidiary, successor, subunit, or any entity under common ownership or control. States must base divestment decisions on credible, public information that a company has invested $20 million or more in Iranian energy sector or is a financial institution that has extended $20 million or more in credit to such an entity. The Bill creates a number of other requirements, related to notice, timing, the opportunity for a hearing, among other things. Additionally, the Bill creates a safe harbor provision for changes of investment policies by asset managers and permits and provides guidelines for fiduciaries of employee benefits programs under the Employee Retirement Income Security Act of 1974 (ERISA) to divest from entities invested in Iran.

Several states either have adopted or are considering legislation that would mandate various forms of disclosure or other actions with regard to companies doing business related to Iran. Some legislation would permit or mandate that state pension funds divest from firms doing business with Iran. These measures vary widely – in terms of the disclosure requirements and the mandatory or permissive nature of divestments. Among potential others, Arizona, California, Florida, Minnesota, New Jersey, and Pennsylvania have enacted laws related to investments in Iran. The effect of the provision in CISADA, as in the case of the Sudan Accountability and Divestment Act of 2007, may be to standardize the form State Iran divestment laws take.

V. Creation of a List of Countries Diverting Items to Iran

The Bill requires that the Director of National Intelligence compile a list of countries that are allowing the diversion of goods, services, or technology to Iran through their territories. The goods, services, or technology at issue are those that originated in the U.S., would make a material contribution to Iran's weapons and ballistic missile development or support for international terrorism, and are on the Commerce Control List or U.S. Munitions List, or are prohibited by UN Security Council resolutions.

The President must designate countries as Destinations of Diversion Control under specified circumstances and must list which goods, services, and technologies are being diverted. The effect of such determinations is that all listed goods, services, and technologies exported to designated countries will require licenses, and applications for licenses will treated with a presumption of denial. The President may delay the imposition of the licensing requirements in 12-month increments under certain circumstances.