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The Obama Administration Tightens the Screws on Iran, Adopts Far-Reaching New Measures

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On July 1, 2010, President Barack Obama signed into law the Comprehensive Iran Sanctions, Accountability and Divestment Act of 2010 ("CIS" or the "Act"). Passed with overwhelming bipartisan support, the Act strengthens and broadens the scope of U.S. sanctions policy against Iran. Perhaps most notably, the Act imposes unprecedented obligations on U.S. financial institutions and directs the Director of National Intelligence ("DNI") to identify countries that allow diversion of goods to Iran, creating the prospect of additional licensing requirements for exports to those countries.

The CIS follows on the heels of new, tougher United Nations measures. The U.N. sanctions – passed by the Security Council on June 9, 2010 – focus primarily on Iran's nuclear weapons program and target the financial and shipping sectors; the U.N. sanctions also prohibit Iran from buying heavy weapons systems such as helicopters and missiles. The European Union similarly has announced its intention to strengthen European sanctions. In a June 17 declaration, European leaders indicated that the new sanctions will focus on trade insurance, the financial sector and other key industries, such as energy, oil and gas, transportation and shipping.

Key Features of the New Law

The CIS builds on the pre-existing Iran Sanctions Act ("ISA"), enacted in 1996, but expands U.S. sanctions in several significant ways. The Act is extensive, and this Alert is intended only to highlight a few of its most notable provisions.

New Requirements for Financial Institutions

The CIS places new responsibilities on U.S. financial institutions, most notably with regard to their relationships with foreign banks. U.S. financial institutions that maintain accounts in the United States for foreign counterparts, such as pass-through or correspondent accounts, must certify that those foreign financial institutions are not engaged in activities with Iran that facilitate its efforts to develop weapons of mass destruction, to support terrorist organizations or to support the activities of sanctioned parties. U.S. financial institutions must audit compliance with these requirements and report any violations to the Treasury Department.

New Restrictions on Exports to Countries of Diversion Concern

The CIS requires the Director of National Intelligence to identify countries that allow diversion of U.S.-origin goods, services and technologies to Iran. The President then must impose additional export licensing restrictions on such countries. The President may delay the additional licensing restrictions if

he determines that the country in question is taking steps to combat the diversion. **This provision carries the potential for significant disruption to U.S. exporters across all industries.** Certain prominent export destinations are known for their laxity in preventing Iran-bound diversion. How they respond to this provision will be of intense interest to many U.S. exporters.

New Sanctions Relating to Iran's Petroleum Industry

The ISA directs the President to impose sanctions on U.S. and non-U.S. companies that provide certain levels of support for or investment in the development of Iran's petroleum resources. (Because virtually all Iran-related transactions are prohibited to U.S. companies, the practical import of the ISA is its impact on non-U.S. entities.) The CIS expands the scope of the ISA to include the **refined petroleum industry**.

The Act prohibits any company from knowingly selling, leasing or providing to Iran goods, services, technology, information or support in excess of $1,000,000 (or any amounts that equal $5,000,000 or more in the aggregate in any 12-month period) that facilitate the maintenance or expansion of Iran's domestic production of refined petroleum products. This includes assistance with respect to construction, modernization or repair of Iran's petroleum refineries.

The CIS also includes within its scope the knowing provision of goods, services, technology, information or support that could directly and significantly contribute to **Iran's ability to import refined petroleum products**. This includes providing ships or shipping services to deliver refined petroleum products to Iran. The CIS defines refined petroleum products to include diesel, gasoline, jet fuel (including naptha-type and kerosene-type jet fuel) and aviation gasoline.

The CIS also expands the definition of "knowingly" to include "should have known," thereby expanding the range of conduct potentially subject to sanctions.

Restriction of Presidential Authority to Waive Sanctions and Expansion of Available Sanctions

Prior to the enactment of the CIS, the President was permitted to waive any "mandatory" sanctions required under the ISA if he believed it "**important** to the national interest" of the United States. No president has ever imposed sanctions for a violation, a fact that has raised the ire of many members of Congress in the past.

Unsurprisingly, the CIS attempts to restrict the President's ability to utilize this waiver power. Under the CIS, the President may waive otherwise mandated sanctions on a case-by-case basis only if he determines that a waiver is "**necessary** to the national interest" of the United States. The import of this change in language remains to be seen, but the inability of Congress to countermand any waiver renders its significance highly uncertain. (We think a court would decline to decide a dispute between the Executive and Legislative branches on this issue on the basis that it presents a nonjusticiable "political question.")

The CIS also adds three new sanctions to the six previously set out in the ISA. The President may choose any combination of these nine sanctions, but in any case – absent a waiver – must apply at least three sanctions for a violation. The available sanctions, as expanded, now include:

(1) Denial of assistance from the Export-Import Bank of the United States;

(2) Denial of licenses for the export of military or military-useful technology to the sanctioned company;

(3) Denial of U.S. bank loans exceeding $10 million in any one year to the sanctioned entity;

(4) If the entity is a financial institution, it can be prohibited from serving as a primary dealer in U.S. government bonds or repository for U.S. government funds;

(5) Prohibition on procurement by the U.S. government from the entity;

(6) Restrictions on imports from the sanctioned company;

(7) Prohibitions on any transactions in foreign exchange that are subject to the jurisdiction of the United States and in which a sanctioned person has any interest;

(8) Prohibitions on any transfers of credit or payments between, by, through or to any financial institution, to the extent that such transfers or payments are subject to the jurisdiction of the United States and involve any interest of the sanctioned person; and

(9) Restrictions on property transactions with respect to which a sanctioned person has any interest.

Expanded Liability for U.S. Parent Companies

The CIS makes two key changes to potential liability for U.S. parents with foreign subsidiaries. The CIS defines a "parent" broadly as any person that "owns or controls" another person, as defined in the CIS. Under the ISA, a foreign person could be independently sanctioned for violating the ISA, but in order for that foreign company's U.S. parent to also be sanctioned directly, the ISA required that the U.S. parent "approve" or "facilitate" the conduct giving rise to the violation. The CIS lowers that threshold, allowing a U.S. parent to be independently sanctioned for the conduct of a foreign subsidiary if the U.S. parent had "actual knowledge or should have known" that its subsidiary was engaged in sanctionable activities. (Of course, a U.S. parent in this circumstance already would face liability under other U.S. sanctions provisions, risking substantial criminal and administrative penalties.)

Increased Criminal Penalties

The CIS also harmonizes and increases the potential criminal penalties for violations of U.S. sanctions prohibitions, increasing the maximums to $1 million per violation and a maximum term of imprisonment of 20 years. These penalties apply to violations of several related statutes but only to persons subject to the jurisdiction of the United States.

Administrative penalties for violations of the U.S. sanctions remain unchanged, at a maximum of $250,000 per violation. Violators also risk suspension of eligibility for export licensing. (The CIS did not affect those provisions.)

Government Procurement Certification

Prospective government contractors must certify that the contractor and its afffiliates do not conduct any activity for which sanctions may be imposed. False certification can result in debarment or suspension from eligibility for federal contracts for up to three years. A General Accounting Office

report found that seven companies involved in the Iranian oil and gas sector received more than $880 million in U.S. government contracts over the past four years.

Authorization for State and Local Divestment

The CIS grants a federal "blessing" to state and local governments that wish to divest from certain companies that invest in Iran. The CIS authorizes states and local governments to divest their assets from companies involved in investments of $20 million or more in Iran's energy sector and sets standards for them to do so. In addition, the CIS provides a safe harbor intended to protect asset managers who choose to divest in accordance with the CIS from suit as a result of such divestment.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings Washington lawyers:

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