

Energy Trade & Commodities Alert

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Pending Iranian Sanctions Could Significantly Impact European Entities

The United States Congress is currently considering legislation that would increase the scope and application of the U.S. sanctions against Iran: The Comprehensive Iran Sanctions, Accountability and Divestment Act of 2009 (S. 2799) and the Iran Refined Petroleum Sanctions Act of 2009 (H.R. 2194). These changes could significantly impact the ability of non-U.S. companies to do business with both Iran and the United States. This article summarizes the proposals under consideration and highlights key provisions that could affect the international operations of European companies.

Overview

As the United States and members of the United Nations (“UN”) Security Council and the European Union (“EU”) weigh proposals to increase multilateral sanctions against Iran, the House and Senate of the United States Congress are simultaneously working on separate legislation that would increase existing U.S. sanctions against Iran. The proposed legislation in the U.S. Congress seeks to limit the activities beyond the “U.S. persons” controlled under existing sanctions to include persons who contract with the United States government.

These proposed sanctions follow increased enforcement efforts by the U.S. Department of the Treasury, Office of Foreign Assets Control (“OFAC”), the U.S. Department of Justice (“DOJ”), and New York City prosecutors, who collectively imposed fines of more than \$750 million in 2009 against European entities found to have violated existing U.S. sanctions.

Given the increasing enforcement focus on Iran and the expanded scope of sanctions under consideration in the U.S. Congress, international and European companies should be aware of how these sanctions could impact their ability to conduct business with Iran and the United States.

Existing Iranian Sanctions

The United States currently enforces a comprehensive sanctions program against Iran. That program is directed primarily at U.S. companies and individuals, although certain provisions apply to non-U.S. persons when handling U.S.-origin goods, acting in the United States, or working on behalf of U.S. companies.

The U.S. sanctions program against Iran is implemented through a number of Executive Orders and the Iranian Transaction Regulations, 31 CFR Part 560 (“ITR”), which are administered by OFAC. The statutory basis for the sanctions are section 505 of the International Security and Development Cooperation Act of 1985 (“ISDCA”) and the International Emergency Economic Powers Act (“IEEPA”). The sanctions have become increasingly strict through a series of Executive Orders issued during the 1990s and changes to the ITR in response to U.S. government concerns that Iran was (is) sponsoring terrorism and pursuing weapons of mass destruction. See, e.g., Executive Order 12957 (March 16, 1995); Executive Order 12959, (May 6, 1995); Executive Order 13059 (Aug. 19, 1997).

With limited exception, the ITR prohibit:

- Imports of Iranian-origin goods or services to the United States, either directly or through third countries
- Export, reexport, sale, supply, or transfer, directly or indirectly, of goods, technology, or services from the United States or by a U.S. person, wherever located, to Iran or the government of Iran
- Investments by U.S. persons, including commitments of funds or other assets, loans or any other extensions of credit, in Iran or in property (including entities) owned or controlled by the government of Iran
- U.S. persons, including foreign branches of U.S. depository institutions and trading companies, from engaging in any transactions, including purchase, sale, transportation,

swap, financing, or brokering transactions related to goods or services of Iranian-origin, or goods or services owned or controlled by the government of Iran

- U.S. persons from engaging in any transaction or dealing in property or interests in property of Iranian financial institutions or banks designated by the U.S. government under the Nonproliferation of Weapons of Mass Destruction (“NPWMD”) or Specially Designated Global Terrorist (“SDGT”) program
- Non-U.S. persons from engaging in certain reexports or retransfers to Iran of goods, technology or services exported from the United States
- U.S. persons from engaging in any “transaction or dealing” related to Iranian-origin goods or services (or goods or services owned or controlled by the government of Iran), or goods, technology or services for exportation, reexportation, sale or supply, directly or indirectly, to Iran or the government of Iran
- U.S. persons, wherever located, from approving, financing, facilitating, or guaranteeing any transaction by a foreign person, where the transaction by the foreign person would be prohibited by the ITR if performed by a U.S. person or within the United States
- U.S. persons from attempting or participating in any transaction that evades or avoids, or has the purpose of evading or avoiding, or attempts to violate, any of the prohibitions of the ITR

ITR §§ 560.201-208.

Existing U.S. sanctions also prohibit U.S. person involvement in the development of petroleum resources in Iran. ITR § 560.209.

The EU currently maintains an arms embargo against Iran and prohibits the export of sensitive technologies to Iran. The United States, the EU, the UN and the United Kingdom (“UK”) prohibit transactions with certain Iranian financial institutions as well, although the United States has restricted more Iranian financial institutions than either the EU or the UK.

Proposed Enhancement of Sanctions

The purpose of the draft legislation is to pressure the government of Iran to suspend and dismantle its nuclear program (to the extent applicable to weapons), including the termination of all uranium enrichment activities. The legislation under consideration would:

- Require OFAC to immediately investigate any person who has supplied refined petroleum products to Iran or supported the production of such products in Iran (i.e., sanctionable activities under the proposed legislation)
- Prohibit any foreign exchange, banking, or property transaction with any person determined to be engaged in sanctionable activity in Iran*
- Require sanctions on entities that invest more than a specified amount of money in businesses involved in Iran’s petroleum industry
- Require sanctions on any entity that provides Iran with refined petroleum resources or engages in an activity that could contribute to Iran’s ability to import such resources
- Prohibit efforts to expand or improve Iran’s oil production or refinery capacity, any related shipments, and any technical or material support for its nuclear weapons or missile programs
- Any company or individual found to have violated these provisions would be unable to lawfully conduct foreign exchange, banking, or property transactions with any person required to comply with U.S. law – effectively ending the company’s ability to do business in U.S. dollars. A sanctioned company would be debarred from any U.S. government contracting (including state and local contracting) and prohibited from purchasing or dealing in U.S.-origin goods, technologies, or services. Sanctioned entities could essentially be prohibited from engaging in all business with U.S. companies.
- The Senate legislation also extends the prohibition on imports of Iranian-origin goods to include all goods. Under the existing sanctions, certain foodstuffs (e.g., caviar) and carpets are excluded from the prohibition.

Additional Impact on Refined Petroleum Transactions

The proposed legislation would impose sanctions on any person who knowingly provides Iran with “refined petroleum products,” or leases or sells to Iran, goods, services, or technologies that could enhance Iran’s ability to import petroleum. See, S. 2799 § 102(a)(3)(A) and H.R.

2194 § 3(a)(2)(A). This prohibition applies to investments in excess of \$200,000, or aggregate investments exceeding \$1 million during any 12-month period.

Bar on Exporters of Sensitive Technology from U.S. Government Contracting

Both the House and Senate proposals would bar a “person that exports sensitive technology to Iran” from U.S. government contracting. S. 2799 § 105(a); see also, H.R. 2194 § 3(c)(1). The definition of sensitive technology includes many items that are already regulated under the Export Administration Regulations, although no language in the proposals would limit the controls to items on the Commerce Control List. In addition, sensitive technology includes any technology that is used to restrict the free flow of unbiased information, or to disrupt, monitor, or otherwise restrict the speech of the people of Iran. S. 1799 § 105(c).

Encouragement of Foreign Government Enforcement

The proposed legislation also attempts to influence foreign government enforcement of sanctions against Iran. Under the House proposal, there will be a presumption of denial for the export or transfer of any nuclear material, facilities, components, or other goods to the countries with jurisdiction over a sanctioned person, unless the country has taken appropriate measures to prevent and punish the person. See H.R. 2194 § 3(c)(2)(A). The Senate version directs the Department of Commerce to assess diversion risk and export controls around the world, and to work with countries with insufficient export controls, or from which illegal diversions have occurred. A failure of the country to cooperate or improve controls could result in country-specific prohibitions.

Increased Potential for Divestment of Energy Sector Investors

The proposed Senate legislation may also affect foreign companies by authorizing state and local governments to divest specified funds from entities that invest in the energy sector in Iran. S. 2799 § 202. This provision is significant as it puts organizations that do not directly engage in sanctioned activities with Iran at risk. Provided that the state or local government complies with certain due process requirements, they are permitted to do one of two things. First, the government body has the option to divest from specified persons, with the support of the United States government, the assets of the state or local government. Assets included here are public monies, such as any pension, retirement, annuity, endowment fund, or similar instrument, which is controlled by the state or local government. Second, states would be permitted to prohibit investment of assets in persons investing the in energy sector of Iran. The investment of assets includes a commitment or contribution of assets, a loan or other extension of credit; and the entry into or renewal of a contract for goods or services.

Where this provision becomes materially significant is by the scope of persons subject to divestment. This section makes no distinction between U.S. and foreign persons. For purposes of this section, the “person” who is subject to divestiture of assets, or prohibition of investment, is “a natural person, corporation, company, business, association, partnership, society, trust, or any other nongovernmental entity, organization, or group; any governmental entity or instrumentality of a government, including a multilateral development institution (as defined in section 1701(c)(3) of the International Financial Institutions Act (22 U.S.C. 262r(c)(3))); and any successor, subunit, parent company, or subsidiary of any entity described [in this definition].” S. 2799 § 201(4).

By including parent companies and subsidiaries in the definition of person, this law requires international companies who transact business with U.S. states to monitor, and potentially terminate, the activities of their subsidiaries, and parent companies, or else be subject to divestment of state assets, including ineligibility for state and local contracting. For example, under this section, a company headquartered in Sweden could be subject to non-renewal of a services contract with a U.S. state, if its subsidiary invests in the energy sector in Iran.

Conclusion

Companies around the world who do business directly or indirectly in Iran should proactively assess their exposure under these proposed sanctions.

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Reed Smith continues to monitor the development of this legislation, as well as other trade sanction issues. Please contact Leigh Hansson or your usual Reed Smith contact for more information or assistance.

* This prohibition would have a limited exception for vital U.S. national security interests.

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