

**NEW U.S. SANCTIONS LAW TARGETS FOREIGN SUPPORT FOR IRAN'S
PETROLEUM INDUSTRY**

On July 1, 2010, President Obama signed into law the “Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010” (the “Act”) (Pub. L. No. 111-195). The Act complements recent multilateral efforts implemented through the United Nations Security Council to pressure Iran to suspend its nuclear enrichment program. The new U.S. law establishes a far-reaching set of unilateral sanctions targeting foreign companies that support Iran’s lucrative energy sector and assist Iran’s efforts to gain increased access to much-needed refined petroleum products.¹ The Act also authorizes, but does not require, state and local governments and their pension funds to divest their portfolios of the securities of companies involved in Iran’s energy sector.

The new law requires the President to impose a specific set of sanctions against non-U.S. firms—including foreign subsidiaries of U.S. companies—identified as significant investors in Iran’s energy sector, suppliers to Iran of refined petroleum products, or providers of other direct support or services to Iran for the development of its energy resources. The new law prohibits foreign companies engaged in sanctionable activities from obtaining U.S. government contracts, denies foreign banking institutions that finance Iran’s energy development access to the U.S. financial system, and reinforces U.S. efforts to stop the diversion of sensitive technologies through third countries to Iran. The sanctions requirement extends to insurers and reinsurers providing services that support Iran’s ability to import refined petroleum products. However, the Act provides an exemption from sanctions for firms providing certain underwriting, insurance, or reinsurance services if the President determines that the firm has undertaken “due diligence” to avoid sanctionable transactions.

The new law took effect on July 1, 2010. Firms should prepare for implementation of the Act by reviewing their business operations and those of their foreign subsidiaries to identify potentially sanctionable activity. Insurance and reinsurance concerns should be sure to put in place a sufficient compliance system so they fall within the safe harbor provision of the Act.

BACKGROUND—EXISTING LAW PRIOR TO JULY 1, 2010

U.S. law already prohibits U.S. companies from doing business in or with Iran, or with the Government of Iran and Iranian nationals or companies. In general, the Iranian Transaction Regulations (the “ITR”) enforced by the U.S. Treasury Department’s Office of Foreign Assets Control (“OFAC”) apply to “U.S. Persons.”² The ITR do not apply to a U.S. company’s foreign

¹ Such products include diesel fuel, gasoline, jet fuel, and aviation gasoline.

² U.S. Person is defined under the ITR to include U.S. nationals (wherever located), persons in the United States, and business entities organized under the laws of the United States.

subsidiaries organized under foreign law. In addition, U.S. Persons may not approve, finance, facilitate, or guarantee transactions by a foreign person involving Iran. The restrictions are very broad, and can lead to inadvertent violations, particularly if transactions touch Iran only indirectly. OFAC interprets the restrictions aggressively, and there is not only strict liability but also the potential for substantial fines for such violations. U.S. Persons trading illegally with Iran can be subject to a civil penalty of up to \$250,000, or twice the value of the transaction, and to criminal penalties of up to \$1 million and/or imprisonment for up to 20 years.

The Iran Sanctions Act and related statutes give the President of the United States authority to impose sanctions on any non-U.S. entity that invests \$20 million or more in Iran's energy sector or that assists Iran in the development of weapons of mass destruction or other military capabilities. If the President determines that a foreign company has engaged in such activity, the President is required to impose two or more sanctions from a statutory menu of six possible sanctions.³ Until now, the laws also gave the President substantial authority to waive sanctions if U.S. "vital national security interests" required the waiver. This extraterritorial sanctions authority was never used because successive U.S. presidents issued national security waivers.

THE COMPREHENSIVE IRAN SANCTIONS, ACCOUNTABILITY, AND DIVESTMENT ACT OF 2010

The Act expands the range of sanctionable activities and those that are potentially subject to sanctions, increases the menu of possible sanctions, and restricts the President's waiver authority.

Sanctionable Activities

The Act requires the President to impose sanctions on foreign persons that "knowingly" engage in certain activities related to Iran's oil and natural gas industries, including:

- Making an "investment"⁴ of more than \$20 million annually in Iran's energy sector, or making any combination of investments of at least \$5 million that, in the aggregate, equal or exceed \$20 million in any 12-month period and that "directly and significantly contribute" to the enhancement of Iran's ability to develop petroleum resources;⁵

³ The possible sanctions include denial of U.S. Export-Import Bank assistance; denial of U.S. export licenses for military technologies; a ban on large loans from U.S. financial institutions; barring a foreign financial institution from dealing in U.S. government securities; a ban on U.S. government contracts; and restrictions on imports.

⁴ The Act expands the definition of "investment" to include entry into, performance, or the financing of a contract to sell or purchase goods, services, or technology for the development of Iran's energy resources.

⁵ The definition of "petroleum resources" was expanded to include petroleum, refined petroleum products, oil or liquefied natural gas, natural gas resources, oil or liquefied natural gas tankers, and products used to construct or maintain pipelines used to transport oil or liquefied natural gas.

- Selling, leasing, or providing to Iran goods, services, technology, information, or support with a fair market value of \$1 million or more, or with an aggregate fair market value of \$5 million or more over a 12-month period, 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 construction, modernization, or repair of petroleum refineries;
- Selling or otherwise providing to Iran refined petroleum products having a fair market value of \$1 million or more, or having an aggregate fair market value of \$5 million in a 12-month period; or
- Selling, leasing, or providing to Iran goods, services, technology, information, or support that has a fair market value of \$1 million or more, or that has an aggregate fair market value of \$5 million or more over a 12-month period, and that could directly and significantly “contribute to the enhancement of Iran’s ability to import refined petroleum products,” including:
 - Underwriting or entering into a contract to provide insurance or reinsurance for the sale, lease, or provision of such goods, services, technology, information, or support (except as falling within the “safe harbor” described below);
 - Financing or brokering such sale, lease, or provision; or
 - Providing ships or shipping services to deliver refined petroleum products to Iran.

Sanctionable Persons

Sanctions may be imposed not only on a foreign person determined by the President to be engaged in sanctionable activities but also on the parent or a subsidiary of such person, depending on the circumstances. The Act requires the President to impose sanctions on a parent that either had actual knowledge or should have known that its affiliate or subsidiary was engaged in sanctionable activities. The President will also be required to impose sanctions on an affiliate or subsidiary of a person determined to have carried out sanctionable activities if the affiliate or subsidiary knowingly engaged in the sanctionable activities.

Limited Safe Harbor for Insurers and Reinsurers Meeting Due Diligence Standards

The Act provides a “safe harbor” from sanctions for a person that provides underwriting services or insurance or reinsurance that contributes to Iran’s ability to import refined petroleum products, provided that the President determines such person “has exercised due diligence” in “establishing and enforcing official policies, procedures, and controls” to ensure that it does not provide insurance or reinsurance for the sale, lease, or provision 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. According to the authors of the Act, such due diligence “would include procedures and controls to prevent such underwriting or the entry

into contracts for such purposes, and the designation of an official with responsibility for enforcing the policy.” In practical terms, this means implementing an Iran-sanctions compliance policy applicable to all company operations. The safe harbor is available, subject to the due diligence conditions, only for activities related to Iran’s ability to import refined petroleum.

Expansion of the President’s “Menu” of Mandatory Sanctions

The Act amends prior law to require the President to impose three (instead of two) sanctions on a sanctioned person and expands the menu of options from which the President can choose from six items to nine, including the following new sanctions:

- Prohibiting transactions in foreign exchange that are subject to the jurisdiction of the United States and in which a sanctioned person has any interest;
- Prohibiting any transfers or 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 a sanctioned person;
- Restricting transactions involving property in which a sanctioned person has an interest, including “acquiring, holding, withholding, using, transferring, withdrawing, transporting, importing, or exporting any property” subject to the jurisdiction of the United States, “dealing in or exercising any right, power, or privilege with respect to such property,” or “conducting any transaction involving such property.”

Restrictions Regarding U.S. Government Contracts

The new law prohibits federal agencies from entering into or renewing a contract with a person that exports “sensitive technology” to Iran. This term is defined as “hardware, software, telecommunications equipment, or any other technology” that is to be used to “restrict the free flow of unbiased information in Iran” to “disrupt, monitor, or otherwise restrict speech of the people of Iran.” However, the term does not include information or informational materials that are exempt from the ITR.

In addition, each prospective federal contractor submitting a bid to the federal government will be required to certify that the contractor, and any person owned or controlled by the contractor, does not engage in any sanctionable activity within the meaning of the Act. A false certification could subject the contractor to termination of existing contracts and/or to suspension or debarment from federal contracts for a period of up to three years.

Restrictions on Subsidiaries of U.S. Financial Institutions

Any person owned or controlled by a U.S. “financial institution,” as that term will be defined by the Treasury Department in regulations to be issued pursuant to the Act, would be prohibited from knowingly engaging in a transaction with or benefiting Iran’s Revolutionary Guard Corps and certain of its agents or affiliates. A U.S. financial institution could be penalized for violations of this prohibition by an entity it owns or controls if the institution knew or should have known of the violation.

Limitations on Access to the U.S. Financial System

The Act requires the Treasury Department to issue regulations that would prohibit or limit the ability of a foreign financial institution to open or maintain a correspondent account or a payable-through account in the United States if the institution provides significant financial services to the Government of Iran or Iran's Revolutionary Guard Corps or otherwise finances or facilitates certain activities by those entities or by the Central Bank of Iran.

Divestment

The new law authorizes, but does not require, a state or local government to adopt and enforce measures to divest the assets of the government from, or prohibit investment of the assets of the government in, any person that the government determines is engaged in investment activities in Iran's energy sector. The provision also includes state and local government pension funds. The new law provides a "safe harbor" from civil, criminal, or administrative action for registered investment companies that change their investment policies to divest from or avoid such investments and expresses the "sense of Congress" that the divestment from, or the avoidance of, such investments is not a breach of fiduciary duty under the Employee Retirement Income Security Act ("ERISA").

Political Analysis—Presidential Waiver Authority

A number of U.S. business groups have expressed concern about the imposition of the Act's unilateral and extraterritorial measures, calling the scope of the new sanctions "worrisome" and warning of the Act's "unintended consequences for legitimate global commerce." Under the Act, the President has some flexibility, including limited authority—on a case-by-case basis—to waive the imposition of sanctions against an individual foreign firm located in a country that cooperates with multilateral efforts against Iran. However, President Obama did not receive the level of flexibility he sought from Congress and the new law generally weakens the extent of presidential discretion granted by prior law.

When President Obama signed the Act into law, he issued a signing statement emphasizing his waiver authority with respect to persons and entities in countries that closely cooperate with multilateral efforts to constrain Iran. Therefore, we expect that the President will seek to exercise his waiver authority to the greatest extent necessary to minimize disruption of commercial relations between the United States and many of its trading partners. However, in view of the overwhelming margins by which the Act was approved by both houses of Congress and the number of "mandates" in the Act, it is unclear whether Congress would be willing to accept the degree of flexibility that the President may assert. U.S. firms should prepare for full implementation of the Act, rather than relying on the prospect of a waiver. This includes a review of outstanding contracts to determine whether they involve, even tangentially, Iran's energy sector and, if necessary, implementing a comprehensive compliance policy.

If you have any questions regarding this memorandum, please contact Mitchell J. Auslander (212-728-8201, mauslander@willkie.com), Leah Campbell (212-728-8217, lcampbell@willkie.com), Russell L. Smith (202-303-1116, rsmith@willkie.com), Miriam A. Bishop (202-303-1126, mbishop@willkie.com), or the Willkie attorney with whom you regularly work.

Willkie Farr & Gallagher LLP is headquartered at 787 Seventh Avenue, New York, NY 10019-6099 and has an office located at 1875 K Street, NW, Washington, DC 20006-1238. Our New York telephone number is (212) 728-8000 and our facsimile number is (212) 728-8111. Our Washington, DC telephone number is (202) 303-1000 and our facsimile number is (202) 303-2000. Our website is located at www.willkie.com.

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