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The Impact Of New Iran Sanctions

Law360, New York (November 16, 2009) -- As a result of new revelations and escalating international concerns regarding the continuing development of Iran's nuclear program, the Obama administration and the U.S. Congress are each moving forward with proposals for additional economic sanctions against Iran that involve measures directed at Iran's international trade transactions, especially those involving petroleum refining and refined petroleum exports to Iran.

The reported Obama administration proposals and the legislation Congress is considering would significantly expand existing U.S. trade sanctions that prohibit U.S. companies from dealing with Iran.

These new sanctions also would single out, among others, entities providing insurance or reinsurance services.

The Obama administration's sanctions could affect most Iranian import and export trade.

Both proposals could ban goods, services, technology, information or activities that support the importation or production of refined petroleum by Iran, including those related to refinery construction, modernization and repair.

Foreign insurers and reinsurers identified by the United States as providing services to Iran's petroleum refining industry could become subject to one or more U.S. sanctions, the effect of which would be to limit or proscribe their ability to do business in the United States.

The Obama administration's possible extension of sanctions and the legislation pending in Congress, together with existing laws restricting insurance transactions that in any way involve Iran and other U.S.-government sanctioned countries, should prompt insurance and reinsurance companies and brokers to create or revise programs designed to avoid noncompliance with current and proposed sanctions.

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Existing Law

U.S. law already prohibits U.S. companies, including insurers and reinsurers, from doing business in or with Iran.

The President of the United States also has discretionary authority to impose, from a menu of available measures, one or more sanctions against non-U.S. individuals and firms that make significant investments in Iran's petroleum industry.

To date, no U.S. president has used this authority.

The current Iran sanctions are part of a broader program of statutory and executive trade sanctions enforced by the U.S. Treasury Department's Office of Foreign Assets Controls ("OFAC").

These apply to Iran, Cuba and Sudan, among others, as well as to individuals and entities that the U.S. government has determined to be involved in terrorism, drug trafficking or other criminal activity.

The sanctions programs restrict economic activity on several levels, ranging from a total ban on all economic activity to limits on investment in selected industries or dealings with prohibited persons.

OFAC regulations also prohibit the facilitation, approval or support by U.S. persons of transactions with sanctioned countries or persons that are carried out by third parties.

The restrictions are complex and there are numerous examples of inadvertent violations, particularly with respect to transactions that only indirectly involve the sanctioned country or entity.

OFAC enforces the restrictions aggressively and imposes strict liability in the form of substantial fines for such violations.

Possible Administration Proposals

President Obama has not yet announced what new steps his administration may take, or threaten to take, to supplement its ongoing diplomatic efforts to persuade the government of Iran to abide by United Nations resolutions and the rules of the International Atomic Energy Agency.

On Sept. 29, 2009, The Washington Post reported that the Obama administration is "prepared by year's end to make it increasingly difficult for Iranian companies to ship goods around the world. The administration is targeting, in particular, the insurance and reinsurance companies that underwrite the risk of such transactions."

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These new sanctions may include proposals, also focusing on insurers and reinsurers, designed to reduce or eliminate further international investment in Iran's oil industry.

The Obama administration has signaled its intention to propose sanctions that would be applied by the United States and its allies if there is not substantial compliance with the commitments Iran made during October diplomatic talks to restrict its nuclear development program.

The Proposed Legislation

Committees in both the House and the Senate have approved different versions of Iran sanctions legislation.

On Oct. 28, 2009, the House Foreign Affairs Committee approved H.R. 2194, the "Iran Refined Petroleum Sanctions Act of 2009."

The House bill would make several changes to existing law. It would limit the president's discretion, making it more likely that sanctions will be imposed on foreign entities investing in Iran's petroleum industry.

In addition, it would expand the types of foreign entities that could be sanctioned by the United States and the activities that could result in sanctions to include the importation and use of refined petroleum, an increasingly important industry sector in Iran.

The House bill would also require that every federal government contractor certify that it has not provided any support to Iran's domestic refined petroleum sector or with respect to the exportation to Iran of refined petroleum.

The House bill would explicitly require the president to impose sanctions against foreign or domestic entities that are "underwriting or otherwise providing insurance or reinsurance" for "any activity that could contribute to the enhancement of Iran's ability to import refined petroleum resources."

This provision would extend the risk of sanctions to any insurance or reinsurance activity that enhances Iran's capacity to import refined petroleum by financing, brokering, underwriting or providing ships or shipping services for the direct export of refined petroleum to Iran, or provides goods or services that support domestic production of refined petroleum in Iran.

If a foreign entity is determined to have engaged in any of the specified activities, the president could choose from among a menu of potential sanctions.

Among other things, the president could essentially bar sanctioned persons from access to U.S. financial institutions and block any sanctioned person's assets located in the United States.

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The sponsors of the House bill have stated that their intent is effectively to prohibit the sanctioned person from doing business in the United States.

On Oct. 29, 2009, the Senate Banking Committee approved the "Comprehensive Iran Sanctions, Accountability and Divestment Act." While the Senate and House bills are similar, there are some significant differences between the two.

Under the Senate bill, a U.S. parent company would be sanctioned for activities of a foreign subsidiary if that subsidiary was established specifically to circumvent U.S. sanctions and invests over $20 million in Iran's energy sector.

The Senate bill permits state and local governments and mutual funds to divest from firms investing in Iran's energy sector and protects private asset managers from fiduciary liability in connection with such divestments.

The House bill does not include these provisions.

The House bill covers any person who "knowingly" (including actual or constructive knowledge) engages in "providing services relating to the shipping or other transportation of refined petroleum products to Iran;" "underwriting or otherwise providing insurance or reinsurance for" such services; "or financing or brokering" such insurance or reinsurance.

The Senate bill is more narrowly targeted, in that it is limited to actual knowledge only.

In addition, it is unclear whether the Senate bill extends sanctions authority to apply to those that provide services to third parties, rather than directly to Iran, in support of Iran's petroleum refining industry.

Outlook

The bills approved by the House and Senate committees are intended to buttress the Obama administration's ongoing diplomatic efforts to force the government of Iran to cease its development of nuclear weapons by severely restricting commercial trade activity connected with Iran's vital petroleum sector.

In a Sept. 27, 2009, commentary in The Washington Post, House Foreign Affairs Committee Chairman Rep. Howard Berman, D-Calif., stated that the United States should be ready to impose immediate and "crippling sanctions" if negotiations with Iran by the U.S. and its allies do not result in a meaningful commitment from Iran to curb its nuclear program.

Berman is pressing for House action on the legislation so that the measure could be ready for President Obama's signature by early 2010, but three other House committees still must act on the bill.

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Senate Banking Committee Chairman Sen. Christopher Dodd, D-Conn., expressed a similar position when his committee approved its bill.

He emphasized that the legislation would “send a signal to Iran’s leaders that, if they continue to defy the will of the international community, our nation is prepared to confront them.”

The two measures have garnered overwhelming support — the House bill had 335 cosponsors as of Nov. 1, and a prior Senate bill had 75 cosponsors.

At the time the House and Senate committees acted, the Obama administration indicated that it did not support sanctions legislation.

However, it is increasingly likely that if Iran fails to fulfill the commitments made during the October negotiations, President Obama will proceed with diplomatic efforts to obtain international consensus on additional Iran sanctions and that those sanctions proposals will target insurers and reinsurers, among others.

If new global sanctions are not adopted, there is a strong likelihood that Congress will want to enact legislation to demonstrate U.S. determination to “punish” Iran.

In that case, Congress would probably pass the legislation with significant bipartisan majorities, making it very difficult for President Obama not to sign it into law.

Insurance and reinsurance companies and brokers could be immediately and directly affected by expanded international or U.S. sanctions against Iran.

While particularly directed at the petroleum industry, these sanctions could extend to all commercial transactions involving Iran.

It will be important, in terms of both achieving compliance and demonstrating good-faith efforts to comply in the event of a violation, that these companies and brokers have comprehensive compliance programs in place and that they are enforcing them effectively.

Companies that have compliance programs should review them carefully to ensure that they are adequate to deal with existing and possible additional sanctions. Companies that do not have such programs should develop and implement them as soon as possible.

--By Mitchell J. Auslander (pictured) and Russell L. Smith, Willkie Farr & Gallagher LLP

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