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President Obama signs law imposing substantial new sanctions on business dealings with Iran

Three Mayer Brown LLP lawyers, Carol J. Bilzi, Timothy J. Keeler, and Simeon M. Kriesberg, analyse the key provisions of the sweeping new Iran sanctions law recently enacted by the United States.

On 1 July 2010, President Obama signed into law a sweeping new Iran sanctions bill – the Comprehensive Iran Sanctions, Accountability and Divestment Act of 2010, HR 2194 (the Act). The Act strengthens US sanctions against Iran by restricting that country's access to, among other things, gasoline and other petroleum products, petroleum-related investment, credit, and financial services; and by otherwise tightening the US trade embargo against Iran. Significantly, the Act authorises sanctions not only on those entities conducting Iran-related business but also on those that own or control such entities. The Act also authorises the US Treasury Department to impose sanctions on foreign financial institutions that engage in certain transactions with Iran.

The Act has a significant extraterritorial reach. US entities and individuals are already prohibited from engaging in virtually all business and financial transactions involving Iran. The Act is specifically designed to target the activities of non-US entities and individuals. The Act amends the Iran Sanctions Act of 1996 (ISA). ISA authorised the President of the United States (the President) to impose sanctions on non-US companies that make significant investments in Iran's petroleum industry. Although no President has ever imposed sanctions under the ISA, the original law required the President to choose two sanctions from a 'menu' of six options: (i) denial of Export-Import Bank assistance for exports to sanctioned persons; (ii) denial of export licenses; (iii) prohibition of loans from US financial institutions; (iv) for sanctioned financial institutions, denial of designation as a primary dealer of US debt instruments or as a repository of government funds; (v) denial of procurement contracts; and (vi) additional sanctions to restrict imports relating to a sanctioned person.

The new knowledge standard

The new law makes several important changes in the ISA. First, a person will be subject to sanctions based on the person's constructive knowledge of conduct, circumstances, or results subject to sanctions, even without actual knowledge. The 'knowingly' standard set by the Act is satisfied where a person 'has actual knowledge, or should have known, of the conduct, the circumstance, or the result.' Under current law, only actual knowledge can give rise to sanctions.

The addition of new activities subject to sanctions

Second, with respect to entities doing business in Iran's petroleum sector and those providing support to such business, activity subject to sanctions is expanded to include:

- knowingly making an investment of $20m or more (or a combination of investments of at least $5m each over a 12-month period amounting to the same figure) that directly and significantly contributes to the enhancement of Iran's ability to develop petroleum resources, where the term 'investment' is enlarged to include the entry into, performance of, or financing of a contract to sell or purchase goods, services, or technology;

- knowingly selling, leasing or providing to Iran goods, services, technology, information or support valued at more than $1m (or more than $5m in the aggregate over a 12-month period) that could directly and significantly facilitate the maintenance or expansion of Iran's domestic production of refined petroleum products or contribute to Iran's ability to import refined petroleum products;
- knowingly selling refined petroleum products to Iran, including diesel, gasoline and jet fuel, meeting the same limits of value.

Activity subject to sanctions also includes knowingly underwriting or providing insurance or reinsurance for the sale of refined petroleum products to Iran, financing or brokering such sale, or providing ships or shipping services to deliver such products to Iran. Underwriters and insurance providers that exercise due diligence to ensure that they do not engage in such activities are granted a safe harbor from the imposition of sanctions.

The expansion of the menu of sanctions that can be imposed

Third, the law establishes three new sanctions: (i) a prohibition against access to foreign exchange in the United States, (ii) a prohibition against access to the US banking system and (iii) a prohibition against property transactions in the United States. The President would be required to impose at least three of the (now) nine available sanctions on any person that 'knowingly' engages in activities subject to sanctions. The law also requires the President to initiate investigations (eliminating the discretion provided under ISA) upon receipt of credible information that a person is engaged in activity subject to sanctions. The effective dates for this new provision vary depending upon the activity involved.

The extension of liability to parent companies

Fourth, if the President sanctions an entity, the scope of liability within the corporate ownership structure has been expanded from current law. The new law mandates that when a company is sanctioned, the person owning or controlling that entity must also be sanctioned if the owner had actual knowledge or should have known of the entity's activities that are subject to sanctions.

The limitation on presidential waivers

The law authorizes the President to grant waivers from sanctions and investigations. These waivers include case-by-case waivers for companies from countries that cooperate closely with US efforts to stop Iran's nuclear fuel enrichment program. The Act also permits the President to avoid initiating an investigation of a person (or to terminate an investigation) if the President determines that the person no longer engages in activities subject to sanctions or has taken significant verifiable steps toward stopping such activities. The President must notify Congress in writing of any waivers, however, thus putting the political spotlight on the President. Indeed, the House Republican leadership has already sent a letter to President Obama urging him not to invoke his waiver authority.

In general, the new provisions relating to Iran's petroleum sector would apply to activity occurring on or after 1 July 2010. However, investigations regarding activities that facilitate the production of refined petroleum within Iran and the exportation of refined petroleum products to Iran will not become mandatory for at least a year.

New measures applicable to financial institutions

In addition to expressly including financing activities in the new definition of 'investment' and in the description of sanctionable activities relating to Iran's refined petroleum production or imports, the Act expands the definition of persons subject to sanctions to include 'financial institutions, insurers, underwriters and guarantors.' The Act takes several other steps to target financial institutions.

Within 90 days of 1 July the US Secretary of the Treasury must issue regulations to prohibit, or impose strict conditions on, the opening or maintaining of US correspondent accounts by foreign financial institutions that knowingly engage in certain targeted activities that facilitate the government of Iran's acquisition or development of weapons of mass destruction, support for terrorism, and similar activities. By prohibiting or limiting the ability of foreign financial institutions to maintain US correspondent accounts, these new provisions will provide the United States with significant leverage to pressure non-US banks to cease engaging in certain business with Iran and with prohibited parties in Iran.

The US Secretary of the Treasury must also issue regulations to require financial institutions in the

United States that maintain correspondent accounts for foreign financial institutions to institute new due diligence or auditing procedures to detect whether foreign financial institution customers are engaging in the prohibited activities with Iran. It is expected that non-US financial institutions operating in the United States will also be required to implement the new due diligence procedures if they maintain US correspondent accounts for foreign financial institutions.

The Act also prohibits any person owned or controlled by a US financial institution from knowingly engaging in a transaction that benefits Iran's Revolutionary Guard Corps or any of its agents or affiliates whose property has been blocked by the United States.

Other new measures

The Act also:

- permits divestment from Iran's energy sector by US states, localities, and certain other investors;
- further limits goods exempted from the embargo against Iran;
- requires a certification from federal contractors that they, and any person owned or controlled by them, do not engage in activities sanctioned under the law;
- bars from US government procurement contracts any foreign companies that provide Iran with technology that can disrupt, monitor, or otherwise restrict private communication (eg, surveillance and electronic jamming technology);
- restricts exports to countries found to be diverting sensitive technologies to Iran; and
- increases criminal penalties for sanctions violations by US entities.

Financial institutions and other companies that currently deal directly or indirectly with Iran will need to study this complex law carefully to determine how it applies to their operations and the operations of entities that they own or control. The impact of the law will depend critically on the way the implementing regulations are drafted and applied, so affected banks, insurers, and other businesses will wish to engage in the regulatory process, just as many did during the legislative process. Much will depend as well on the extent to which the President employs the waiver authority that the law grants.

Finally, the prospect that parent companies may be sanctioned for activities in which affiliates have engaged without the actual knowledge of the parent companies, as well as the safe harbor for diligent insurers and underwriters, will place a premium on the development and implementation of effective internal controls, compliance programs, and due diligence procedures.

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