

California Becomes First State to Ban Firms Doing Business With Iran from State Contracts

The cost of doing business with Iran's petroleum, natural gas, and nuclear industries just went up. Effective June 1, 2011, companies, financial institutions, and governments that are active in Iran's energy sector may be banned from doing business with the State of California.

As a matter of federal law, the United States for many years has barred US companies and financial institutions from virtually all dealings with Iran. In 2010, Congress extended US sanctions to foreign parties involved in Iran's energy sector through the Comprehensive Iran Sanctions, Accountability, and Divestment Act (CISADA). Section 202 of CISADA authorized state and local governments to divest their funds from parties involved in Iran's energy sector and to bar such parties from state and local government contracts. California is the first state in the nation to enact a law pursuant to Section 202.

California's Iran Contracting Act (AB1650, Statutes of 2010, Public Contract Code § 2201 et. seq.) (the Act) bars persons determined to be engaged in investment activities in Iran's petroleum, natural gas or nuclear industries from bidding on or renewing contracts with California state and local governments for goods and services worth \$1 million or more. The Act requires bidders and contractors to certify that they are not on a list of persons engaged in defined investment activities in Iran prior to bidding on or renewing a contract. Furthermore, financial institutions must certify that they are

not extending credit of \$20 million or more to anyone on the list if the credit is to be used to provide goods or services to Iran's energy sector.

The Act sets forth two categories of persons who may be barred from contracting with the State and its political subdivisions as a result of their activities related to the development of petroleum or natural gas resources or nuclear energy in Iran:

- Persons that "provide goods or services of twenty million dollars (\$20,000,000) or more in the energy sector of Iran including a person that provides oil or liquefied natural gas tankers, or products used to construct or maintain pipelines used to transport oil or liquefied natural gas for the energy sector of Iran." Section 2202.5(a) (Subdivision (a)).
- Financial institutions (including depository institutions, credit unions, securities firms (including broker-dealers), insurance companies, and other financial services providers) "that extend twenty million dollars (\$20,000,000) or more in credit to another person, for 45 days or more, if that person will use the credit to provide goods or services in the energy sector in Iran and is identified as a person engaging in investment activities in Iran as described in [S]ubdivision (a)." Section 2202.5 (Subdivision (b)).

In April, California's Department of General Services (DGS) began sending letters alerting companies and financial institutions alleged to

be engaged in prohibited investment activities related to Iran's energy sector that they would be placed on a list of persons ineligible to bid for contracts of \$1 million or more with the State and local governments. Under the Act, only persons engaging in activities described in Subdivision (a) should appear on this list; financial institutions will not be able to determine whether they are engaging in activities described in Subdivision (b) until the list is published.

Any party receiving such a letter has 90 days from receipt to respond in writing to DGS and demonstrate why it should not be listed. DGS expects to publish the first version of the list of parties engaged in Iran investment activities in August 2011, after the 90-day comment period has closed. The Act requires that the list be updated every 180 days.

The Act directs DGS to compile the list based on "credible information available to the public." The term "credible information" is not defined. Due to budget constraints, DGS did not retain outside consultants to assist in developing a list. Instead, DGS relied on articles found in major newspapers and on the website maintained by the non-profit advocacy group United Against a Nuclear Iran (UANI). The UANI website posts summaries of media reports concerning major international companies that do business with Iran. Notably, the Act expressly requires that DGS "make every effort to avoid erroneously including a person on the list." This echoes the congressional caution in CISADA that a state or locality must "ha[ve] made every effort to avoid erroneously targeting [a] person and ha[ve] verified that the person engages in the investment activities in Iran" pertaining to the energy sector.

Once the list is published, parties submitting bids or proposals or entering into or renewing a contract for goods or services with a State or local government agency in California are required to certify at the time the bid or contract is executed that they are not a "person" identified on the list

pursuant to Subdivision (a). Financial institutions bidding on contracts will have 30 days after each list is published to certify that they are not engaging in credit activities identified under Subdivision (b).

For a bidder or contractor that falsely certifies that it is not engaged in the specified energy-sector activities, and that fails to demonstrate that it has ceased its prohibited activities within 90 days of a determination of a false certification, the penalties may include: a civil fine of the greater of \$250,000 or twice the amount of the contract for which the false certification was made; termination of the contract if it was awarded to the bidder or contractor; and a three-year debarment from bidding on other contracts for goods and services with State or local government agencies.

A safe harbor provision in the Act permits persons identified on the list to bid for or renew contracts for goods or services of \$1 million or more with State and local agencies. These persons will be permitted to do so (i) if DGS, or the awarding agency, determines that it is in the best interest of the agency to contract with the listed party and (ii) if the energy-sector activities in Iran were initiated before July 1, 2010, the activities have not been expanded or renewed after July 1, 2010, and the person has adopted, has publicized, and is implementing a formal plan to cease such activities in Iran and to refrain from engaging in new activities.

In addition, the Act authorizes the Governor or a local agency to contract with a person engaged in the prohibited activities upon a public finding that it would be impossible for the State or local agency to obtain certain goods or services without contracting with the listed person.

The Act places additional pressure on foreign companies and financial institutions to cease activities that promote the Iranian energy sector. Because DGS may not have the most accurate and comprehensive information regarding a company's or financial institution's activities in

Iran, foreign firms may need to challenge DGS's preliminary determinations so that the firms do not appear erroneously on the DGS list. Furthermore, although California is the first, it is not likely to be the last state to enact Iran sanctions at the invitation of CISADA. Foreign companies and financial institutions will now have to be alert not only to US federal laws but also to state and local laws relating to Iran.

For further information about the Act, or any other matter raised in this Legal Update, please contact any of the following lawyers.

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