

# KIRKLAND ALERT

July 2010

## New Legislation Further Lengthens Reach of Extraterritorial Application of U.S. Embargo of Iran

In the wake of the June 9, 2010 adoption of United Nations Security Council Resolution 1929, on July 1, 2010, President Obama signed into law H.R. 2194, the “Comprehensive Iran Sanction, Accountability, and Divestment Act of 2010” (“CISADA”), which had been approved by both the U.S. House of Representatives and the U.S. Senate on June 24, 2010 by overwhelming majorities of 408 - 8 and 99 - 0, respectively. The legislation principally expands the scope of the Iran Sanctions Act (“ISA”) to more effectively target persons, including non-U.S. entities, engaged in activities relating to the Iranian petroleum sector. In addition, the legislation provides, in part, for the imposition of sanctions on financial institutions and those persons deemed responsible for human rights abuses in Iran stemming from the disputed 2009 elections, imposes restrictions on government procurement contracts, and authorizes certain divestment measures by state and local governments. Each of these, as well as certain additional key aspects of the legislation, are summarized below.

### I. Expanded ISA Sanctions

Originally enacted as the Iran and Libya Sanctions Act of 1996, the ISA has been perceived by Congress to be ineffectual, largely due to the unwillingness of successive administrations to impose any of the sanctions measures set forth in the ISA despite incontrovertible evidence that certain non-U.S. entities had been engaging in sanctionable activities. Accordingly, in addition to expanding the scope of the ISA to include additional categories of sanctionable activity, as well as additional sanctions measures, the CISADA requires the President immediately to investigate a person upon receipt of credible information that such person is engaged in sanctionable activity and seeks to limit the President’s waiver authority.

#### A. Additional Categories of Sanctionable Activity

Unless waived, as discussed below, the CISADA, which extended the ISA until December 31, 2016, requires that the President impose sanctions against any “person” that “knowingly”<sup>1</sup> engages in the following activities:

- Investments that directly and significantly contribute to the enhancement of Iran’s ability to develop petroleum resources of \$20 million or more (or a combination of such investments during any 12-month period if each such investment is of at least \$5 million and such investments equal or exceed \$20 million). The term “petroleum resources” includes 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;
- Sales, leases, or the provision otherwise to Iran of goods, services, technology, information, or support, any of which has a fair market value of \$1 million or more (or that collectively have a fair market value of \$5 million or more during any 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 the construction, modernization, or repair of petroleum refineries;
- Sales or the provision otherwise to Iran of refined petroleum products, or associated goods, services technology, information, or support that could directly and significantly contribute to the enhancement of Iran’s

ability to import refined petroleum products, having a fair market value of \$1 million or more (or that have an aggregate fair market value of \$5 million or more during any 12-month period).<sup>2</sup> For purposes of the CISADA, the term “refined petroleum products” means diesel, gasoline, jet fuel (including naphtha-type and kerosene-type jet fuel, and aviation gasoline. The types of services contemplated by the CISADA include insurance and reinsurance contracting,<sup>3</sup> financing or brokering, and shipping.

### **B. Additional Available Sanctions**

Previously, the President was required to impose two or more sanctions from a “menu” of six to counter sanctionable activity:

- Prohibitions on Export-Import Bank assistance for exports to sanctioned persons;
- Prohibitions on the issuance of export licenses to sanctioned parties;
- Prohibitions on loans or the provision of credits by U.S. financial institutions to any sanctioned person totaling more than \$10 million in any 12-month period;
- Prohibitions on financial institutions determined to be sanctioned persons from being designated as “primary dealers” in U.S. Government debt instruments and from serving as agents of the U.S. Government or as repositories for U.S. Government funds;
- Prohibitions on U.S. Government procurement; and
- Restrictions on the importation of goods with respect to a sanctioned person.

The CISADA adds an additional three sanctions to this “menu” and requires that the President impose at least three of the nine types of sanctions in connection with activity determined to violate the petroleum-related sanctions provision set forth in the CISADA:

- Prohibitions on transactions in foreign exchange that are subject to the jurisdiction of the United States and in which the sanctioned person has any interest;
- Prohibitions on transfers of credit or payments between financial institutions or by, through, or

to any financial institution, to the extent that such payments or transfers are subject to the jurisdiction of the United States and involve any interest of the sanctioned person; and

- Prohibitions on (i) acquiring, holding, withholding, using, transferring, withdrawing, transporting, importing, or exporting any property that is subject to the jurisdiction of the United States and with respect to which the sanctioned person has any interest; (ii) dealing in or exercising any right, power, or privilege with respect to such property; or (iii) conducting any transaction involving such property.

### **C. Affected Parties**

The ISA originally defined the term “person” to mean a (i) natural person; (ii) a corporation, business association, partnership, society, trust, any other nongovernmental entity, organization or group, and any governmental entity acting as a business enterprise; and (iii) and successor to any of the above-described entities, regardless of the person’s nationality. The CISADA expands the definition of “person” to include financial institutions, insurers, underwriters, guarantors, and any other business organization. In addition, the CISADA specifically provides that the parent, subsidiaries, and affiliates of a person determined by the President to be engaged in sanctionable activities also may be sanctioned. However, sanctions may only be imposed if the parent had actual knowledge or should have known that that its subsidiary or affiliate engaged in sanctionable activities or, in the case of a subsidiary or affiliate of a person engaged in sanctionable activities, the subsidiary or affiliate also knowingly engaged in such activities.

### **D. Presidential Certification and Waiver Authority**

To incentivize companies that have elected to withdraw from Iran, the CISADA allows the President not to initiate an investigation, or to terminate an investigation, if the President certifies to Congress that the person whose activities were the basis for the investigation is no longer engaging in such activities or has taken significant steps toward ceasing the activity and the President has received reliable, verifiable assurances that the person will not knowingly engaged in such activities in the future.

Furthermore, the CISADA preserves the President's right to waive the imposition of sanctions. As a general matter, sanctions may be waived if the waiver is "necessary to the national interest." This is a higher standard than that set forth in the original ISA, which allowed for waivers determined to be "important to the national interest."

In addition, the CISADA authorizes the President on a case-by-case basis to waive for a period of not more than 12 months (renewable in 12-month increments) the imposition of sanctions against a person upon certification to Congress that the government having primary jurisdiction over the person is "closely cooperating" with the United States in multilateral efforts to prevent Iran from (i) acquiring or developing chemical, biological, or nuclear weapons or related technologies, including ballistic missiles or delivery systems, or destabilizing numbers and types of advanced conventional weapons; and (ii) such waiver is "vital to the national security interests of the United States." Although it remains unclear how the President will interpret this waiver provision, President Obama signaled in the signing statement to accompany H.R. 2194 that this waiver authority is critically important to the Administration:

The Act provides a powerful tool against Iran's development of nuclear weapons and support of terrorism, while at the same time preserving flexibility to time and calibrate sanctions. In particular, it provides new authority for addressing the situation of those countries that are closely cooperating in multilateral efforts to constrain Iran. The Act appropriately provides this special authority to waive the application of petroleum-related sanctions provisions to a person from such a closely cooperating country, out of recognition of the key role such a country plays in ongoing multilateral efforts to constrain Iran. The Act permits the President to exercise this authority flexibly, as warranted, and when vital to the national security interests of the United States.

## II. Restrictions on Transfers of Nuclear Technology

For persons found to be engaging in sanctionable activity under the ISA as a result of the acquisition or development of nuclear weapons or related technology or of missiles or advanced conventional weapons that are designed or modified to deliver a nuclear weapon, the CISADA prohibits the issuance of export licenses or approvals for the transfer or retransfer, directly or indirectly, to the country having primary jurisdiction over the person of certain nuclear technology that are or would be subject to a nuclear cooperation agreement with the United States. Such sanctions may be waived if the President certifies to Congress that the government of the relevant country (i) does not know or have reason to know about the activity; or (ii) has taken, or is taking, all reasonable steps necessary to prevent a recurrence of the activity and to penalize the person for the activity. In addition, the President may, on a case-by-case basis, approve authorizations for nuclear exports to the extent such exports are "vital to the national security interests of the United States" and Congress has been provided a justification for such action.

## III. Prohibitions on Procurement Contracts

The CISADA mandates a revision to the Federal Acquisition Regulations to require persons that are prospective U.S. Government contractors, to include persons owned or controlled by the contractor, to certify that the contractor is not engaging in sanctionable activity under the ISA. False certifications could result in the termination of the contract or the debarment or suspension of the contractor from eligibility for U.S. Government contracts for a period of not more than 3 years.

In addition, the CISADA prohibits agencies of the U.S. Government from entering into or renewing contracts for the procurement of goods or services with a person that exports "sensitive technology" to Iran. Such technology includes hardware, software, telecommunications equipment, and any other technology that the President determines is being used (i)

to restrict the free flow of unbiased information in Iran; or (ii) to disrupt, monitor, or otherwise restrict the speech of the Iranian people.

#### IV. Financial Institutions Sanctions

The CISADA directs the Department of the Treasury to promulgate implementing regulations prescribing prohibitions, or the imposition of strict conditions, on the opening or maintaining in the United States by U.S. financial institutions of “correspondent” or “payable-through” accounts<sup>4</sup> by a foreign financial institution that knowingly:

- Facilitates the efforts of the Government of Iran, including the Islamic Revolutionary Guard Corps (“IRGC”) or any of its agents or affiliates, to (i) acquire or develop weapons of mass destruction or related delivery systems; or (ii) to provide support for entities designated as “foreign terrorist organizations;”
- Facilitates the activities of persons subject to financial sanctions pursuant to a resolution of the United Nations Security Council;
- Engages in money laundering in support of the above-described activities;
- Facilitates efforts by the Central Bank of Iran or any other Iranian financial institution to carry out the above-described activities;
- Facilitates a significant transaction or transactions or provides significant financial services for the IRGC or any of its agents or affiliates, or financial institutions, subject to U.S. blocking measures.

If a foreign financial institution does not cease its activities, the Department of the Treasury may direct U.S. financial institutions to sever such accounts. Violations of these provisions will be subject to the imposition of civil or criminal penalties in accordance with the International Emergency Economic Powers Act, as amended (“IEEPA”). The IEEPA authorizes civil penalties in an amount not to exceed the greater of \$250,000 per violation or twice the value of the underlying transaction. Criminal penalties cannot exceed \$1,000,000 and/or up to 20 years imprisonment.

In addition, the CISADA requires that U.S. financial institutions having correspondent or payable-through

accounts (i) audit the above-described activities of the foreign financial institutions for which such accounts are maintained; (ii) report any transactions or financial services provided with respect to such transactions; (iii) establish due diligence policies, procedures, and controls to ensure that such foreign financial institutions are not knowingly engaging in such activities; and (iv) certify to the best of its knowledge that the foreign financial institution is not knowingly engaged in any such activities. Violations of these provisions will be subject to the penalties prescribed by the USA PATRIOT Act. Please note, however, that the Secretary of the Treasury may waive a prohibition or condition imposed on a foreign financial institution or the imposition of a penalty on a U.S. financial institution if it is determined that such a waiver is “necessary to the national interest of the United States” and Congress is appropriately notified.

Finally, the CISADA directs the Department of the Treasury to promulgate implementing regulations prohibiting any person owned or controlled by a U.S. financial institution from knowingly engaging in a transaction or transactions with or benefitting the IRGC or any of its agents or affiliates subject to U.S. blocking measures. Violations of these provisions will subject the U.S. parent institution to penalties pursuant to the IEEPA to the extent such parent knew or should have known that an entity owned or controlled by such parent engaged in the sanctionable activity.

#### V. Sanctions on Persons Responsible for Human Rights Abuses

The CISADA requires that the President compile a list of persons who are officials of the Government of Iran or persons acting on behalf of the Government of Iran that are determined to have been responsible for or complicit in, or responsible for ordering, controlling, or otherwise directing, the commission of serious human rights abuses against Iranian citizens in connection with the elections held on June 12, 2009.

Listed persons may be denied visas to enter the United States and may be subject to sanctions pursuant to the IEEPA, including the blocking of property and restrictions or prohibitions on financial transactions and the exportation or importation of property.

## VI. Tightening of Economic Sanctions

The legislation codifies the import and export prohibitions set forth in the Iranian Transactions Regulations maintained by the Department of the Treasury's Office of Foreign Assets Control. Regarding imports, the CISADA eliminates the exceptions from the import ban for Iranian carpets and foodstuffs, but maintains exceptions for information and informational materials and "accompanied baggage for personal use." Regarding exports, the legislation adopts the near total ban on exports to Iran from the United States to Iran, or by U.S. persons wherever located, but retains existing exceptions for food, medicine, and humanitarian assistance, as well as information and informational materials, Internet communications and technology, and spare parts and components for commercial aircraft. The legislation further authorizes the President, consistent with existing Executive Orders, to freeze the assets of individuals or entities satisfying the criteria for designation in accordance with the IEEPA.

## VII. Destinations of Diversion Concern

Within 180 days of the enactment of the CISADA, the Director of National Intelligence is required to submit a report to the President, the Secretary of Defense, the Secretary of Commerce, the Secretary of State, the Secretary of the Treasury, and the appropriate congressional committees identifying those countries believed to be allowing the diversion of the following goods, services, or technologies to Iranian end users or intermediaries:

- Goods, services, or technologies that (i) originated in the United States; (ii) would make a material contribution to Iran's development of nuclear, chemical, or biological weapons, ballistic missile or advanced conventional weapons capabilities, or support for international terrorism; and (iii) are items on the Commerce Control List or services relating to such items or are defense articles or defense services on the United States Munitions List; or
- Goods, services, or technologies that are prohibited for export to Iran pursuant to a resolution of the United Nations Security Council.

Based on this list, the President is required to designate a country that allows "substantial" diversion as a

Destination of Diversion Concern. In making this determination, the President may consider (i) the volume of goods, services, or technologies being diverted; (ii) the inadequacy of the export control regime; (iii) the unwillingness or demonstrated inability of the country to control the diversion; and (iv) the unwillingness or inability of the country to cooperate with the United States in interdiction efforts.

As a consequence of designation, the President will impose new export licensing requirements pursuant to the Export Administration Regulations and International Traffic in Arms Regulations for the items being diverted. Applications for licenses to export such items will be subject to a presumption of denial.

## VIII. Harmonization of Criminal Penalties

The CISADA harmonizes the criminal penalty provisions of the United Nations Participation Act, the Arms Export Control Act (the legislation authorizing the International Traffic in Arms Regulations), and the Trading with the Enemy Act (the legislation authorizing the Cuban embargo) to comport with the IEEPA.

## IX. State and Local Government Divestment Measures

Subject to certain procedural requirements, the CISADA explicitly authorizes state and local government authorities to adopt and enforce measures to divest assets, or prohibit the investment of the assets in, any person determined using credible information available to the public:

- Having an investment of \$20 million or more in the Iranian energy sector, 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 Iranian energy sector; or
- Is a financial institution that extends \$20 million or more in credit to another person, for 45 days or more, if that person will use the credit for investment in the Iranian energy sector.

Pursuant to the CISADA, such measures are not preempted by federal law. Furthermore, the CISADA "grandfathers" already enacted divestment measures regardless of their scope.

- <sup>1</sup> The CISADA broadens the definition of the term “knowingly” to include both actual knowledge and circumstances whereby a person “should have known” that certain conduct constitutes a violation of the ISA.
- <sup>2</sup> The requirement that the President initiate an investigation relating to activities supporting Iran’s domestic product of refined petroleum products and the importation into Iran of refined petroleum products will not take effect until one year after the date of enactment of the CISADA.
- <sup>3</sup> Persons providing underwriting or insurance or reinsurance services are excepted from the imposition of sanctions if the President determines that such persons have exercised due diligence in establishing and enforcing official policies, procedures, and controls.
- <sup>4</sup> These terms are defined by reference to Section 311 of the USA PATRIOT Act (31 U.S.C. § 5318A).

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