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United States: New U.S. Iranian Sanction Provisions Require More Diligence on Part of Both Foreign and U.S. Firms, Including Financial Institutions

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The U.S. Comprehensive Iran Sanctions, Accountability, and Divestment Act (CISADA) of 2010, which was signed into law on July 1, expands the extraterritorial reach of the prior Iranian sanctions provisions and imposes new responsibilities on U.S. companies, including financial institutions. For example, U.S. companies will now have greater responsibility for monitoring the activities of subsidiaries, or entities under their ownership and control. Given this expanded reach, the enhanced sanctions and new limitations on presidential waivers, companies would be well-advised to *re-evaluate their existing due diligence procedures* to determine if they are adequate. This article highlights some of these new provisions and heightened responsibilities.

Under U.S. law, U.S. companies are prohibited from doing business in or with Iran, or with the Government of Iran and Iranian nationals or companies under the Iranian Transaction Regulations (the "ITR") enforced by the U.S. Treasury Department's Office of Foreign Assets Control ("OFAC"). The CISADA applies extraterritorially to foreign companies that engage in certain prohibited activity with Iran. As discussed below, under certain circumstances, CISADA also adds new liabilities to U.S. companies that have relationships with these foreign offenders.

Sanctions For Activity Relating To Refined Petroleum

The Iran Sanctions Act of 1996 (ISA) imposed sanctions on foreign persons that invest in the development of Iran's petroleum resources, provided certain monetary thresholds were met.¹ CISADA expands the sanctionable activities to sales of refined petroleum to Iran and assistance to Iran for its own domestic refining capacity. Specifically, under CISADA, foreign firms that "knowingly" engage in the following activities are now subject to sanctions:²

1) Facilitating Iran's Domestic Production of Refined Petroleum Products

Selling, leasing, or providing "goods, services, technology, information, or support" to Iran 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"; or

2) Providing Refined Petroleum Products

Selling or providing refined petroleum products (i.e., diesel, gasoline, jet fuel, and aviation gasoline) to Iran; or

3) Enhancing Iran's Ability to Import Refined Petroleum

Selling, leasing or providing "goods, services, technology, information, or support" to Iran that "could directly and significantly contribute to the enhancement of Iran's ability to import refined petroleum products."³

The new sanctions, with a focus on Iran's domestic refining capacity, are designed to increase pressure on Iran in an area where the country is vulnerable. Despite being one of the world's leading oil producers, Iran's limited domestic refining capacity causes the country to import between 25 and 40 percent of its refined petroleum needs.

Expansion of Entities Covered and Lowered Knowledge Test

CISADA also expands the reach of the existing prohibitions in two other important respects. First, the definition of "persons" has been expanded to cover a financial institution, insurer, underwriter, guarantor, or any other business organization. Thus, financial institutions could now be subject to sanctions if they finance sanctionable activities. Second, the applicable knowledge standard has been revised to establish a violation not only on the basis of actual knowledge, but also where the person or entity "should have known." This new standard will require companies to look for "red flags" and institute new, and more stringent internal controls.

This new knowledge test applies to corporate parents, subsidiaries, or other affiliates of the company engaged in sanctionable activity. Thus a parent company⁴ may be subject to sanctions if it has "actual knowledge or should have known" that its subsidiary was engaging in sanctionable activities, even if the parent company was not involved in such activity itself. The ISA provision establishing that a successor company is liable for the actions of its predecessor company remains in effect.

CISADA provides a "due diligence" exception⁵ for insurers, reinsurers, and underwriters who might otherwise be caught up in the prohibition against providing support that contributes to the enhancement of Iran's ability to import refined petroleum products. It is not clear why the "due diligence" exception is limited to these entities, but other entities that could potentially be subject to the reach of CISADA would be well advised to establish and enforce policies, procedures and controls to safeguard against violating these provisions as well.

CISADA Removes Some Of The Discretion In Prior Law And Adds Greater "Teeth" To Sanction Provisions

The extraterritorial sanctions authority under the ISA was never used because successive U.S. presidents issued national security waivers. This loophole has been tightened as, under the CISADA the waiver authority would extend only to cases where the waiver is "necessary to the national interest." This standard is intended to be a more restrictive standard than the "important to the national interest" standard in the ISA. Further, in order to issue a waiver, the President would have to provide a detailed report to Congress explaining the need to waive sanctions. The current political environment will also likely discourage use of the waiver provision.

CISADA increases both the range of possible sanctions and the number of sanctions required to be imposed. Prior law required the President to impose two out of six possible sanctions on a sanctioned entity. CISADA adds three new possible sanctions and requires the President to impose any three out of the nine possible sanctions.⁶ The three new possible sanctions are: 1) prohibition on foreign exchange transactions subject to U.S. jurisdiction; 2) prohibition on banking transactions; and 3) prohibition on transactions involving property of the sanctioned entity.

CISADA now requires mandatory investigations into the possible imposition of sanctions – the President is required to initiate investigations upon receipt of "credible information" that a person is engaged in sanctionable activities. However, the President need not initiate or may terminate an investigation if the President certifies in writing to the appropriate congressional committee that the person whose activity was the basis for the investigation is no longer engaging in the activity at issue, has taken significant steps toward stopping the activity, or has provided reliable assurances that it will not knowingly engage in such activities in the future.⁷ Sanctions may be waived on a case-by-case basis for up to twelve months where the President certifies that the government with primary jurisdiction over the person under investigation is closely cooperating with the United States in multilateral efforts to prevent Iran from: (1) acquiring or developing chemical, biological or nuclear weapons or related technologies; or (2) acquiring or developing destabilizing numbers and types of advanced conventional weapons, and such waiver is "vital" to the national security interests of the United States.

Financial Institutions

As the CISADA Conference Report states, the Act presents foreign banks doing business with blacklisted Iranian entities a stark choice – cease your activities or be denied critical access to America's financial system. CISADA bans U.S. banks from engaging in financial transactions with foreign banks that do business with Iran's Islamic Revolutionary Guard Corps (IRGC), or otherwise facilitate Iran's illicit nuclear program or its support of terrorism. The full extent of some of these restrictions will not be known until the Treasury Department prescribes regulations implementing the Act.⁸

CISADA prohibits foreign subsidiaries of U.S. companies from engaging in any transaction involving IRGC, its agents or affiliates. In addition, the Act holds U.S. banks accountable for actions by their foreign subsidiaries, if the U.S. bank "knew or should have known" that the subsidiary violated, attempted to violate, conspired to violate, or caused a violation of such regulations.⁹ Civil penalties are authorized up to the greater of \$250,000 or twice the amount of the transaction that is the basis of the violation.

U.S. banks maintaining correspondent or payable-through accounts¹⁰ for foreign financial institutions will be required to take appropriate steps to ensure that they remain in full compliance with the law, which may include due diligence policies, procedures, and control. Domestic financial institutions are required to conduct audits of their correspondent or payable-through accounts, report to the Treasury Department on compliance, and certify that the foreign financial institutions using such accounts are not engaged in sanctionable activities. Depending on the scope of the Treasury regulations implementing these requirements, the regulatory burden of these requirements could prove costly for financial institutions.

Government Procurement

Companies seeking U.S. government procurement contracts must self-certify that neither they, nor any person "owned or controlled" by them engage in sanctionable activities, subject to limited exceptions and waiver. If the contractor submits a false certification, the contractor is ineligible for federal contracts for up to three years.

The act also imposes a ban on contractors that provide "sensitive" internet or communications technology to Iran that is used to suppress free flow of information or freedom of speech in the country.

Anti-Diversion

CISADA requires the President to identify each country whose government allows the diversion through that country of specified goods, services or technologies to Iranian end users or Iranian intermediaries. Covered goods, services and technology include: (i) U.S. origin items that would make a material contribution to Iran's weapons of mass destruction (WMD) capabilities or to the support of international terrorism, and are on the U.S. export control lists; and (ii) items prohibited for export to Iran by a United Nations Security Council resolution. When the President determines that a country is a Destination of Diversion Concern, U.S. export licenses will be required to export covered items to such a country with the presumption of denial.

Divestment From Companies Investing In Iran

The Act also authorizes U.S. investment funds to divest share in companies that invest in Iran's energy sector. CISADA provides a "safe harbor" from civil, criminal, or administrative action for registered investment companies that change their investment policies.

Conclusion

While the CISADA is designed to broaden the reach of the Iranian sanctions provisions to foreign entities, it will also force U.S. entities to increase due diligence controls over their subsidiaries and U.S. banks to increase due diligence review of the foreign financial institutions with which they do business.

Footnotes

1. The level of investment must be \$20 million or more or a combination of investments of at least \$5 million that equal or exceed \$20 million in the aggregate over a 12 month period.
2. Providing that such activities: (1) have a fair market value of \$1 million or more, or (2) an aggregate fair market value of \$5 million or more over a 12-month period.
3. This provision includes underwriting, insurance, reinsurance, financing, brokering, and shipping services.
4. A parent company is defined as an entity that "owns or controls" the acting company.
5. To be eligible for this exception, the CISADA Conference Report indicates that due diligence measures must include a designated compliance official with responsibility for enforcing policies, procedures and controls.
6. This applies to both the new provisions relating to refined petroleum products as well as the prior provision relating to the development of petroleum resources.
7. The CISADA Conference Report indicates that the purpose of this provision is to provide an incentive for companies that are withdrawing from Iran.
8. These regulations are due within 90 days of the July 1 enactment date, or September 29, 2010.
9. U.S. companies have long been banned from all the activities for which foreign entities will be sanctionable under this Act.

10. "Correspondent accounts" are accounts established to receive deposits from, make payments on behalf of a foreign financial institution, or handle other financial transactions related to such institution. The term "payable-through account" means an account opened at a depository institution by a foreign financial institution by means of which the foreign financial institution permits its customers to engage, either directly or through a subaccount, in banking activities usual in connection with the business of banking in the United States.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

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