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SANCTIONS

This BNA Insights article by Alan Kashdan and Scott Wise of Hughes Hubbard & Reed LLP examines U.S. extraterritorial sanctions against Iran that have been in a state of partial suspension since late January 2014. While many companies have assumed that they already can, or will soon be able to, enter the Iranian market without concern about the potential application of extraterritorial U.S. sanctions, that is not the case at present, the authors say, and companies run a significant risk of exposure to U.S. sanctions if they act without taking those sanctions into account. While it is possible that the interim Joint Plan of Action negotiated between Iran and the five permanent members of the UN Security Council, plus Germany, will lead to a permanent relaxation of sanctions against Iran, the authors say the post-JPOA landscape is very unclear, and the issue of Iran sanctions may well be a hot topic during the U.S. mid-term Congressional election cycle.

U.S. Extraterritorial Sanctions Against Iran—No, They Haven't Gone Away

BY ALAN KASHDAN AND SCOTT WISE

I. Introduction.

U.S. extraterritorial sanctions against Iran have been in a state of partial suspension since late January 2014, when the Joint Plan of Action negotiated between Iran and the so-called P5+1 (the five permanent members of the UN Security Council—China, France, Russia, the UK and the U.S.—plus Germany) went into effect. Under the Joint Plan of Action (JPOA), Iran agreed both to temporarily halt development of its nuclear program and dismantle some of its aspects in exchange for temporary and limited relief from international and U.S. sanctions for a period of six months. The interim agreement was designed to allow the parties sufficient time to negotiate a permanent agreement to address Iran's nuclear program and, presumably, lead to a more permanent and extensive dismantling of the international sanctions regime against Iran. At the end of July, the parties agreed to extend the JPOA until Nov. 24, 2014, to allow the parties additional time to negotiate.

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While it is possible that the interim JPOA will still lead to a permanent relaxation of sanctions against Iran, including applicable U.S. sanctions with extraterritorial application, many companies have assumed that they already can, or will soon be able to, enter the Iranian market without concern about the potential application of extraterritorial U.S. sanctions. At least at present, that is not the case, and companies run a significant risk of exposure to U.S. sanctions if they act without taking those sanctions into account.

The JPOA has in fact left the vast majority of U.S. sanctions against Iran intact, and the post-JPOA landscape is very unclear. This lack of clarity applies to non-U.S. persons subject to the extraterritorial reach of U.S. sanctions even more than to U.S. companies, for whom the direct U.S. sanctions that apply remain almost totally intact, and are likely to continue for some time in some form even if international sanctions are lifted.

This article provides an overview of current U.S. sanctions with extraterritorial application, and considers the limited exceptions carved out by the JPOA. Finally, it briefly evaluates the short-term implications for companies that are affected by the U.S. extraterritorial sanctions against Iran.

II. Evolution of Extraterritorial Application of Iran Sanctions. *Application of Direct U.S. Sanctions Outside U.S. Borders: the ITSR.*

The U.S. instituted its first sanctions against Iran in 1979, following the seizure of the U.S. embassy and the taking of U.S. hostages in Tehran. In their current form, the U.S. sanctions, now known as the Iran Transaction and Sanctions Regulations (ITSR), primarily prohibit U.S. persons from doing almost any form of business in or with Iran, its government, its companies, or its nationals.

[T]he [Iran Transaction and Sanctions Regulations] prohibit U.S. financial institutions from processing transactions in which any Iranian party has an interest. As a result, dollar denominated transactions with Iran that involve non-U.S. parties that would otherwise not be subject to the ITSR will be captured by the U.S. sanctions when presented for clearance through the U.S. financial system, where U.S. banks must reject the transaction.

While the ITSR primarily are directed at the activities of U.S. persons, they contain a number of provisions with extraterritorial effect. First, they prohibit non-U.S. persons from engaging in the re-export of U.S.-origin goods, software, technology or services, as well as the export to Iran of many non-U.S. items that include more than 10 percent U.S. content. As amended in 2012, the ITSR also prohibit non-U.S. companies that are owned or controlled by U.S. persons from engaging in any transaction with Iran that a U.S. person could not undertake.

Second, even where a non-U.S. business is not subject to the ITSR prohibitions, U.S. nationals (which includes dual nationals and U.S. permanent residents) are subject to the ITSR for their acts anywhere in the world. This means that even when U.S. nationals work outside the U.S. for non-U.S. companies, they are still subject to all of the prohibitions in the ITSR.

Third, the ITSR prohibit U.S. financial institutions from processing transactions in which any Iranian party has an interest. As a result, dollar denominated transactions with Iran that involve non-U.S. parties that would otherwise not be subject to the ITSR will be captured by the U.S. sanctions when presented for clearance through the U.S. financial system, where U.S. banks must reject the transaction. In recent years this caused a number of major European banks to attempt to conceal the Iranian origin of a transaction when presenting dollar denominated payments to U.S. banks for clearance by ''stripping'' out any references to Iran. The U.S. Government views this as an attempted evasion of the ITSR, and has imposed penalties on a number of non-U.S. banks in the hundreds of millions and even billions of dollars.

Importantly, none of the extraterritorial aspects of the ITSR described above were affected by the JPOA, and with very limited exceptions (discussed towards the end of this article), all remain in full force today.

The Proliferation of U.S. Extraterritorial Sanctions.

Concerned that Iran was using revenue from its oil sales to fund both its support of international terrorism and a program to develop nuclear weapons, beginning in 1996 with the enactment of the Iran and Libya Sanctions Act (subsequently renamed the Iran Sanctions Act, or ISA), the U.S. began imposing an increasingly broad array of extraterritorial sanctions targeted at the activities of non-U.S. persons in or with Iran. These sanctions require no nexus to the U.S., a U.S. person, or a U.S. good. Instead, they seek to discourage non-U.S. parties from engaging in certain activities in or with an Iranian party, under threat of being denied access to the U.S. market if they choose to violate the sanctions.

When first enacted, the ISA required the U.S. president to impose a series of sanctions if a non-U.S. person invested more than $20 million in Iran's petrochemical sector—regardless of that person's nationality, location, or ownership. In response to pressure from U.S. allies, however, the authority under ISA was not enforced.

[T]here are now 12 distinct sanction measures that may be imposed against non-U.S. persons for specified activities involving Iran.

Beginning in 2006, however, U.S. allies and the broader international community began accepting that Iran was actively seeking to develop nuclear weapons, and the UN itself imposed targeted but mandatory international sanctions against Iran. Following on UN action President Barack Obama signed into law the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (CISADA), which broadened U.S. extraterritorial sanctions against Iran in two key ways. First, the scope of activities involving Iran that could result in sanctions was broadened. For example, CISADA amended ISA to prohibit the provision of products or services to Iran that would facilitate Iran's ability to refine petroleum. Second, the number and type of sanctions that could be imposed increased. As subsequently amended by other laws (discussed below), there are now 12 distinct sanction measures that may be imposed against non-U.S. persons for specified activities involving Iran:

- prohibition on issuance of U.S. export licenses to export anything to a sanctioned person;

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- prohibition on U.S. financial institutions' loans to sanctioned persons;
- prohibition on designation of a financial institution as a primary dealer in U.S. Government debt instruments or as a repository of U.S. Government funds;
- prohibition on U.S. Government procurement from sanctioned persons;
- prohibition on any transaction in foreign exchange that is subject to U.S. jurisdiction that involves a sanctioned person;
- prohibition on U.S. banking transactions that involve an interest of a sanctioned person;
- blocking of property and interests of property of sanctioned persons that come under U.S. jurisdiction;
- prohibition on U.S. Export -Import Bank financing to any sanctioned person;
- a ban on any U.S. person investing in a sanctioned person;
- exclusion from the U.S. of corporate officers of the sanctioned foreign person;
- sanctions directly on the principal executive officer or officers of the sanctioned person; and
- restriction or prohibition on imports into the U.S. with respect to a sanctioned person.

CISADA was followed by two other laws that further expanded U.S. sanctions against Iran. The Iran Threat Reduction and Syria Human Rights Act of 2012 (ITRA) and the Iran Freedom and Counter-Proliferation Act of 2012 (IFCA) focused on limiting the development of Iran's energy and financial services sectors, amending ISA to broaden its extraterritorial scope to also capture activities in the energy, shipping, and infrastructure sectors (providing services or support with respect to infrastructure that is directly associated with Iran's domestic production and shipment of crude oil and refined petroleum products, including construction of port facilities, railways, and roads used to support the delivery of refined petroleum products). It also added to the list of sanctionable activities the provision of insurance or reinsurance for transactions involving the transport of Iranian oil, and purchasing, subscribing to, or facilitating the issuance of sovereign debt of the Government of Iran. It continued the trend begun with CISADA of increasing the number and the types of sanctions that can be imposed.

The ITRA also codified a variety of previous executive orders pertinent to sanctions against Iran. Of these, Executive Order 13608 is especially notable for allowing sanctions against foreign persons who evade, conspire to violate, or cause a violation of U.S. sanctions against Iran. It also captures the facilitation of deceptive practices on behalf of a person subject to U.S. sanctions against Iran. Last, Executive Order 13645, enacted in the summer of 2013, threatened additional sectoral sanctions on non-U.S. persons for activities in Iran, including in its automotive sector.

Sanctions Targeted at Foreign Financial Institutions. CISADA also introduced a new weapon into the U.S. arsenal of extraterritorial sanctions. Recognizing the key role of banks in funding and processing payments that could supply Iran with funds to carry out its nuclear program, CISADA specifically targeted non-U.S. financial institutions. In particular, a foreign financial institution may be subject to sanctions upon a finding by the Treasury Department that, in any location or currency, it ''knowingly'' engaged or engages in, among others, the following activities:

- facilitating the efforts of the Government of Iran to acquire or develop weapons of mass destruction (WMD) or to provide support for organizations designated as foreign terrorist organizations or support for acts of international terrorism;
- facilitating the activities of a person subject to financial sanctions pursuant to listed UN Security Council Resolutions, or any other resolution adopted by the Security Council that imposes sanctions with respect to Iran (these entities are all incorporated into the U.S. Specially Designated Nationals (SDN) list);
- engaging in money laundering to carry out an activity described in preceding paragraph (1) or (2); and
- facilitating efforts by the Central Bank of Iran or any other Iranian financial institution to carry out an activity described in preceding paragraph (1) or (2).

These provisions are reflected in OFAC's implementing Iranian Financial Sanctions Regulations (ISFR), at 31 C.F.R. § 561.201(a). Where the Secretary of the Treasury determines that a foreign financial institution has knowingly engaged in one of the above activities, the Secretary of Treasury must either: 1) prohibit U.S. financial institutions from opening or maintaining a correspondent and payable-through account in the U.S. for that foreign financial institution, or 2) impose one or more ''strict conditions'' on the opening or maintaining of a correspondent or payable-through account in the U.S. for that foreign financial institution. In other words, foreign banks engaging in these activities are threatened with being cut off from access to the U.S. financial system.

Additional financial sanctions were authorized by section 1245 of the National Defense Authorization Act of 2012 (NDAA). Whereas the activities of foreign financial institutions covered by CISADA involve knowingly engaging in certain listed activities with Iran's Iranian Revolutionary Guard Corps, or that otherwise facilitate Iran's illicit nuclear program or its support of terrorism, the NDAA addresses more broadly the activities of foreign financial institutions that ''knowingly'' conduct or facilitate any ''significant financial transaction'' with either the Central Bank of Iran or a ''designated Iranian financial institution.'' For this purpose, a designated Iranian financial institution is any Iranian financial institution on the U.S. SDN list for reasons of supporting Iran's nuclear programs or for financing terrorism. Like the CISADA provisions discussed above, Section 1245 of the NDAA requires the president to prohibit the opening of, and prohibit or impose ''strict conditions'' on the maintenance of, U.S. correspondent or payable-though accounts of foreign financial institutions where the president has determined such institutions engaged in certain activities.

Indeed, viewed as a holistic regime, and considering the nature of Iran's economy, there are very few transactions regarding Iran that the U.S. sanctions regime does not have the potential to impact. Even where a transaction might not be touched by the U.S. sanctions, the threat of financial sector sanctions may make it difficult if not impossible to carry out the transaction.

The IFCA, discussed above, also has provisions related to foreign financial institutions. Specifically, the IFCA requires that the president prohibit the opening, or impose strict conditions on maintaining, correspondent or payable-through accounts with foreign financial institutions that the president determines have facilitated a significant financial transaction on behalf of any Iranian person on the SDN list. These sanctions may not be imposed, however, with respect to transactions for the sale of agricultural commodities, medicines, or medical devices to Iran or for the provision of humanitarian assistance to the people of Iran.

U.S. State Government Sanctions.

An often overlooked element of the U.S. extraterritorial sanctions regime against Iran is the set of laws enacted by a number of state governments that target certain activities in Iran by non-U.S. companies. These state laws can affect actions at the level of both state and local governments within the state.

The state laws fall into two general categories. The first category forbids state and municipal contracting authorities from entering into contracts with persons who are deemed to have made certain investments in Iran's petrochemical sector that would also be covered by the Iran Sanctions Act. Several states have enacted this procurement restriction, including New York, California and Florida. Only in California do the restrictions not reach the municipal level.

The second category prohibits pension funds for state and local government employees from acquiring shares in companies that have made certain investments in Iran. In the event that a company in which the fund owns stock subsequently makes a prohibited investment, the law would require the fund to divest itself of its holdings in that company. Versions of this restriction are on the books in California, Florida and Illinois, among others.

Challenges.

The net result of these overlapping instruments is a web of extraterritorial sanctions that threatens any non-U.S. company engaging in business with Iran or thinking about doing so. Indeed, viewed as a holistic regime, and considering the nature of Iran's economy, there are very few transactions regarding Iran that the U.S. sanctions regime does not have the potential to impact. Even where a transaction might not be touched by the U.S. sanctions, the threat of financial sector sanctions may make it difficult if not impossible to carry out the transaction. The proliferation of U.S. extraterritorial sanctions, combined with sanctions by other governments and international bodies including the European Union and UN, has simply caused many major multinational companies to cease or significantly limit operations in Iran.

III. Joint Plan of Action—A Partial and Temporary Suspension. The combination of the significant impact of international sanctions on Iran's economy and the election of Hassan Rouhani as president of Iran in 2013 led to a greater willingness by Iran to discuss its nuclear program. In this new environment, the P5+1 nations negotiated an agreement with Iran that relaxed a few elements of the international sanctions regime against Iran in exchange for commitments from Iran regarding its nuclear program. Coming into effect on Jan. 20, 2014, the JPOA relaxed a small part of U.S. extraterritorial sanctions related to Iran's export of petrochemical products, export of crude oil, and sanctions related to Iran's auto industry. Notably, with the minor exceptions of trade in items for safety in civil aviation, humanitarian transactions, and trade in certain personal communication devices and computers, the U.S. did not at all relax the prohibitions on U.S. persons, including non-U.S. subsidiaries of U.S. companies.

The U.S. Treasury and State departments have been very clear regarding the limitations of the JPOA. In a joint Jan. 20, 2014 release, State and Treasury characterized the sanctions relief afforded Iran under the JPOA as ''limited, targeted, and reversible.'' Additionally, the departments noted that the U.S. was free to revoke any relief offered if Iran did not meet its obligations under the JPOA, and that any violations of sanctions that were not relaxed would be pursued vigorously.

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Further restrictions apply to companies seeking to execute transactions under the JPOA umbrella that otherwise would have been prohibited by U.S. sanctions. These restrictions include protection only for transactions that are both commenced and completed during the time that the JPOA is in effect. OFAC has taken this restriction very seriously. Indeed, in the week following the JPOA coming into effect, OFAC issued two civil penalties and enforcement actions against financial institutions that had violated Iran sanctions totaling over $160 million. This followed State and Treasury's statement that they would continue to impose sanctions dur-

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ing the JPOA period for violations that occurred before Jan. 20, 2014.

Current State of Play.

The JPOA was scheduled to expire on July 20, 2014. However, the day before its expiration, the agreement was extended by mutual consent of the P5+1, the EU, and Iran. The extension runs through Nov. 24, 2014. Therefore, assuming that the deadline is not re-extended, the JPOA period will have run for ten months, after which the sanctions will be reimposed in full, or will be modified in some way based on success in the negotiations. The scope of the substantive sanctions relief offered by the July 24 extension is coextensive with the original JPOA—all sanctions not explicitly waived remain in full effect, and the limitations on the waivers also remain.

The initial JPOA led many companies to believe that they were now free from, or would soon be free from, the threat of U.S. extraterritorial sanctions against Iran. The former is certainly not the case. The U.S. government has been very clear that extant sanctions remain fully in effect, unless they are specifically exempted by the JPOA. As explained above, those exemptions are fairly narrow.

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With regard to the future, it is simply impossible to say what the post-JPOA landscape looks like for companies that want to enter the Iran market. After the Nov. 24 expiration of the extended JPOA, there are three basic scenarios: termination of the JPOA; re-extension of the JPOA; and expanded relief from sanctions. While the fact that the JPOA was extended from its original July 2014 deadline can be taken as an indication that all parties retain some optimism of reaching a permanent solution, there is very little to indicate which of these three potential outcomes is the most likely.

IV. Conclusion. Given the uncertainty surrounding how U.S. Iran sanctions will apply to non-U.S. companies, there are a few factors to consider when devising a long-term strategy for compliance with the extraterritorial sanctions against Iran. First and foremost, companies must be mindful of the narrowness of both the scope and time restrictions relevant to the JPOA. For companies that do choose to take advantage of the relief offered under the JPOA, they would do well to conclude those transactions within the JPOA period. Given the uncertainty regarding the landscape after the JPOA, it is possible that a company's risk under Iran sanctions would either be fully restored or would increase, depending on the resolution.

Indeed, there is some reason to believe that sanctions against Iran could increase without a successful outcome from the JPOA. Given that the JPOA will lapse right around the U.S. mid-term Congressional election cycle, Iran sanctions may well be a hot topic during the election season. This may tempt members of Congress to tee up even harsher sanctions in the event no permanent agreement is reached. For now, companies wishing to operate in Iran should exercise caution, not assume any outcome is more likely than any other, and evaluate each proposed transaction very cautiously.