Imposing A New Round Of Sanctions On Iran

Law360, New York (December 01, 2011, 1:05 PM ET) -- On Nov. 21, 2011, the Obama administration released a package of new sanctions on Iran. The new sanctions impact the financial services and other sectors. They expand existing sanctions to target the supply of goods, services, technology or support for the "development" of Iran's "petroleum resources" and the "maintenance or expansion" of Iran's "petrochemical industry." They also designate the Islamic Republic of Iran as a "jurisdiction of primary money laundering concern" under Section 311 of the U.S. Patriot Act.

Sanctions Under Executive Order 13590

Acting under authority of the International Emergency Economic Powers Act ("IEEPA") and other statutes, on Nov. 21 President Obama signed Executive Order 13590, Sections 1(a) and (b) of which impose sanctions similar to those under Section 102(a) of the Comprehensive Iran Sanctions, Accountability and Divestment Act of 2010 ("CISADA").

The new sanctions apply extraterritorially to "any person" (not only to any "U.S. person") in relation to two new activities:

1. Knowingly providing goods, services, technology or support with a fair market value of $1 million or more or, during any 12-month period, an aggregate fair market value of $5 million or more, that "could directly and significantly contribute to the maintenance or enhancement of Iran's ability to develop petroleum resources located in Iran." This prohibition is similar to the first prohibited activity under CISADA, but it lowers the threshold significantly from CISADA's $20 million threshold. The executive order defines the term "to develop" petroleum resources to mean "to explore for, or to extract, refine, or transport by pipeline, petroleum resources."
2. Knowingly providing goods, services, technology or support with a fair market value of $250,000 or more or, during any 12-month period, an aggregate fair market value of $1 million or more, that could "directly and significantly contribute to the maintenance or expansion of Iran's domestic production of petrochemical products." This prohibition is similar to, but broader in its application than, the third CISADA prohibited activity, which covers "refined petroleum products." In addition, the trigger thresholds are much lower than CISADA's $1 million/$5 million for that prohibited activity. The executive order defines "petrochemical products" to mean any aromatic, olefin, and synthesis gas, and any of their derivatives, including ethylene, propylene, butadiene, benzene, toluene, xylene, ammonia, methanol and urea.

The executive order, effective upon issuance Nov. 21, contains no grandfather provision to allow for preexisting contracts. As with CISADA, there are vague and undefined terms in the executive order, such as "services," "support," and "directly and significantly."

Sections 1(c) and (d) of the executive order provide for successor and parent liability for

such activity (subject to a knowledge standard in the case of a parent). Moreover, Section 1(e) provides for affiliate and subsidiary liability if the affiliate or subsidiary "knowingly participated" in the prohibited activity.

In addition, Section 4(b) of the executive order prohibits "any conspiracy formed to violate any of the prohibitions" set forth in the executive order. The anti-conspiracy provision on its face is not limited to "United States persons" or activities within the United States, and therefore it should be construed to apply extraterritorially and to provide a further basis for sanctioning activity covered under the executive order.

The executive order specifically contemplates sanctions against financial institutions and stipulates sanctions against them, up to and including prohibitions on foreign exchange transactions subject to U.S. jurisdiction, prohibitions on transfers of credit and payments through the U.S. financial system and blocking of their property located in the United States.

The executive order is thus similar to, but separate from, CISADA. It is issued under statutory authority separate from CISADA. It imposes mandatory (not optional) sanctions under Section 3(a) (" the Secretary of the Treasury, in consultation with the Secretary of State, shall take the following actions"). It at once supplements and expands the types of sanctioned activity under CISADA through its broader reach and lower dollar thresholds.

Because the executive order entered into effect immediately upon its promulgation, concerned financial institutions and other companies will undoubtedly want to review on an urgent basis their existing or proposed contracts, if any, which might be construed as running afoul of the above prohibitions.

Designation of Iran As a Jurisdiction of Primary Money Laundering Concern

The other major element of the new sanctions package is the designation of Iran as a "jurisdiction of primary money laundering concern" under Section 311 of the Patriot Act because of Iran's support for terrorism, pursuit of weapons of mass destruction ("WMD"), reliance on state-owned or controlled agencies to facilitate WMD proliferation and the illicit and deceptive financial activities that Iranian financial institutions — including , but not limited to, the Central Bank of Iran — and other state-controlled agencies engage in to facilitate Iran's illicit conduct and to evade sanctions.

Based on the above finding by Treasury, the Financial Crimes Enforcement Network issued a notice of proposed rulemaking to implement the finding. Specifically, FinCEN invoked the so-called "fifth special measure" under Section 311, which authorizes FinCEN to prohibit U.S. financial institutions from establishing or maintaining correspondent or payable-through accounts in the United States with a targeted bank or banks from a targeted geographic area.

By making the broad finding that the entire country of Iran is a "jurisdiction of primary money laundering concern," the practical effect of the finding, coupled with the proposed

rulemaking, is to bar all Iranian banks (both in Iran and outside Iran) from correspondent or payable-through account relationships with U.S. financial institutions.

The Central Bank of Iran and most major Iranian banks are already on the Office of Foreign Assets Control's Specially Designated Nationals List ("SDN List"), and therefore U.S. persons have been prohibited from dealing with them for some time. However, the finding in the proposed rulemaking extends that prohibition to the relatively few Iranian banks which have not to date been designated on the SDN List.

As a practical matter, because U.S. financial institutions are already prohibited from dealing with most Iranian banks, the effect of the finding and proposed rulemaking on U.S. financial institutions is relatively limited and relates to what FinCEN describes as "reasonable steps to apply special due diligence."

As explained in the proposed rulemaking, "special due diligence" has two elements. First, a covered financial institution must provide a one-time notice to correspondent account holders that they may not provide Iranian banking institutions with access to the correspondent account maintained at the covered financial institution in the United States.

Second, a covered financial institution must take "reasonable steps" to identify any indirect use of its correspondent accounts by Iranian banking institutions, but only to the extent that such indirect use can be determined from transactional records maintained by the covered financial institution in the normal course of business. These are the minimal requirements under the proposed rulemaking.

Beyond that, a covered financial institution is instructed to take a "risk-based approach" to deciding what, if any, additional due diligence measures it should adopt to guard against improper indirect use of its correspondent accounts by Iranian banking institutions, based on factors such as the types of services it offers and the geographical locations of its correspondents.

FinCEN elaborates in its proposed rulemaking that a covered financial institution would be expected to apply an appropriate screening mechanism to be able to identify a funds transfer order that on its face listed an Iranian banking institution as the originator's or beneficiary's financial institution, or otherwise referenced an Iranian banking institution in a manner detectable under the financial institution's normal screening processes.

A covered financial institution that obtains knowledge that a correspondent account is being used by a foreign bank to provide indirect access to an Iranian banking institution must take "all appropriate steps" to prevent such indirect access, including notification to the correspondent account holder and, where necessary, termination of the correspondent account.

However, the proposed rulemaking specifically does not require financial institutions to prevent indirect access to correspondent accounts when such access is necessary to conduct transactions involving Iranian banking institutions that are licensed under either

general or specific licenses by OFAC or which are exempt from, or otherwise not prohibited by, the IEEPA.

Thus, for example, transactions involving exports of food, medicine or medical devices licensed by OFAC under the Trade Sanctions Reform and Export Enhancement Act of 2000 ("TSRA") and which involve Iranian banks, would still be permissible. Similarly, transactions involving reexports of EAR 99 de minimis U.S. content under OFAC's current Iranian Transactions Regulations would also continue to be permitted.

In addition to the above measures, the administration also designated 11 new Iranian individuals and entities as SDNs on Nov. 21. The same day, in a coordinated effort, the United Kingdom and Canada issued separate enhanced sanctions against Iran. Other U.S. allies are expected to do likewise, although Russia has sharply criticized the new sanctions.

Important questions remain as to how the Treasury will implement or enforce the new sanctions. It is unclear whether the Treasury will pursue dialog or warnings prior to enforcing (both of which, at least informally, were suggested by President Obama at the time he signed CISADA) or whether the new sanctions signal a more aggressive approach to enforcement following congressional criticism of the administration's allegedly slow enforcement of CISADA.

It also is unclear how broadly the Treasury will construe vague terms like "services" or "support." For example, it is not clear whether a simple financing by a non-U.S. bank of importation of Iranian oil into that bank's home country would be viewed as significantly "contributing to the maintenance or enhancement of Iran's ability to develop its petroleum resources."

The administration is aware of the need to avoid disruption of supplies to allies, as well as to avoid disruptions to the world economy, but until further guidance or interpretation is issued, questions will remain.

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