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US Enacts Additional Iran-Related Sanctions; OFAC Amends Iranian Sanctions Regulations to Cover Entities Owned by US Persons

On January 2, 2013, President Obama signed the National Defense Authorization Act for Fiscal Year 2013 (the "2013 NDAA") into law.¹ Provisions of the 2013 NDAA, entitled the "Iran Freedom and Counter-Proliferation Act of 2012" (the "IFCPA"), expand Iranian sanctions to target companies (whether or not acting within U.S. jurisdiction) that engage in a variety of new activities, including:

- Supplying goods and services to the energy, shipping and shipbuilding sectors of Iran;
- Selling, supplying or transferring precious metals, graphite, raw or semi-finished metals (e.g., aluminum and steel), coal and software for integrating industrial processes to or from certain entities in Iran;
- Facilitating significant financial transactions for the above activities or on behalf of Iranian persons on OFAC's List of Specially Designated Nationals and Blocked Persons (the "SDN List"); and
- Providing underwriting, insurance or reinsurance services with respect to sanctioned Iran-related activities.

The new extraterritorial sanctions provisions are broadly defined and often vague, leaving companies dependent on the U.S. Administration's enforcement discretion in unclear cases.

One week earlier, on December 26, 2012, OFAC amended its Iranian Transactions and Sanctions Regulations (the "ITSR") to implement portions of the Iran Threat Reduction and Syria Human Rights Act of 2012 (the "ITRA"), as well as certain Iran-related provisions of Executive Orders 13622 and 13628.² Notably, these amendments to the ITSR

¹ See National Defense Authorization Act for Fiscal Year 2013, H.R. 4310, 112th Cong. (2012).

² See 77 Fed. Reg. 75,845 (Dec. 26, 2012) (amending 31 C.F.R. Part 560); Executive Order 13622 (July 30, 2012) (Authorizing Additional Sanctions With Respect to Iran); and Executive Order 13628 (Oct. 9, 2012) (Authorizing the Implementation of Certain Sanctions Set Forth in the Iran Threat Reduction and Syria Human Rights Act of 2012 and Additional Sanctions With Respect to Iran). For additional detail on the ITRA, please see our August 13, 2012, memorandum, available at

provide additional detail regarding the prohibition against non-U.S. entities that are owned or controlled by a U.S. person (“U.S.-Owned Entities”) knowingly engaging in transactions with Iran or Iranian entities that would be prohibited to a U.S. person—prohibitions that, prior to the October 9 Executive Order implementing ITRA, did not apply to non-U.S. subsidiaries and other entities controlled by U.S. persons.

This alert memorandum describes the key features and changes in law resulting from these two recent developments.

New Sanctions under the IFCPA

Energy, Shipping and Shipbuilding. Section 1244 of the IFCPA contains several provisions authorizing the imposition of U.S. sanctions on entities engaged in activities related to the Iranian energy, shipping and shipbuilding sectors, based on a Congressional finding that the operation of ports in Iran and the Iranian energy, shipping and shipbuilding sectors provide important revenue for Iran’s nuclear proliferation activities.³ Section 1244:

- Instructs the President to designate as a Specially Designated National (“SDN”) subject to full U.S. sanctions any person he determines (i) is part of the Iranian energy, shipping or shipbuilding sectors; (ii) operates an Iranian port; or (iii) knowingly provides significant financial, material, technological or other support to, or goods or services in support of any activity or transaction on behalf of or for the benefit of, a person designated under (i) or (ii).
- Authorizes the imposition of five or more of the twelve sanctions under the Iran Sanctions Act of 1996 (the “ISA”) against any person that the President determines knowingly sells, supplies or transfers to or from Iran “significant goods or services” used in connection with the energy, shipping or shipbuilding sectors of Iran, specifically including the National Iranian Oil Company, the National Iranian Tanker Company and the Islamic Republic of Iran Shipping Lines.⁴
- Provides exemptions (i) with respect to the purchase or exportation of petroleum and petroleum products (under largely the same conditions as included in the National Defense Authorization Act for Fiscal Year 2012, as amended (the “2012 NDAA”));⁵ (ii) with respect to the sale, supply or transfer to or from Iran of natural

http://www.cgsh.com/new_legislation_marks_significant_expansion_of_us_sanctions_against_iran_and_syria/.

³ As an indication of Congress’ continued interest in Iranian shipping and transport activities, Section 1251 of the IFCPA requires the President to provide to Congress annually (i) a list of large or significant vessels that have entered seaports in Iran controlled by the Tidewater Middle East Company, and the owners and operators of those vessels; and (ii) a list of all airports at which aircraft owned or controlled by sanctioned Iranian air carriers have landed.

⁴ For a description of the available sanctions, please see our memorandum on the ITRA, supra note 2.

⁵ Under the exemption in Section 1244, which parallels the existing 2012 NDAA exemptions (as amended by the ITRA), the purchase of petroleum or petroleum products from Iran is not sanctionable

gas (subject to the conditions on associated financial transactions discussed below); (iii) for sales of agricultural commodities, food, medicine or medical devices to Iran or for humanitarian assistance to the people of Iran; and (iv), to the extent the President determines an exemption is in the national interest, for reconstruction assistance or economic development for Afghanistan.⁶

The “energy, shipping and shipbuilding sectors of Iran” are not defined. In particular, it is unclear whether the “energy” sector is limited to previously sanctioned oil and gas activities or includes activities such as civilian power generation.

Section 1244 also effectively adds a new condition to the 2012 NDAA’s requirement that payment due to Iran in connection with imports of Iranian oil (and now, natural gas) be made only to an account in the home jurisdiction of the paying bank and used only for trade between the home jurisdiction and Iran. All such payments now must also be for trade in goods or services “not otherwise subject to sanctions under the law of the United States.” This condition is also somewhat unclear, but it appears to be aimed at transactions that otherwise violate or are sanctionable under U.S. law in light of the goods and parties actually involved in the transaction (since of course trade in all goods and services is subject to U.S. sanctions if the parties are within U.S. jurisdiction).

Persons dealing with Iranian SDNs. Section 1244 also instructs the President to designate as an SDN any person that knowingly provides significant financial, material, technological or other support to, or goods or services in support of any activity or transaction on behalf of or for the benefit of, any Iranian person on the SDN List other than Iranian financial institutions that are listed on the SDN List but not designated under the Iranian Financial Sanctions Regulations (the “IFSR”).⁷ The exemptions for petroleum purchases, natural gas, agricultural commodities or other humanitarian goods or aid, and

unless a Presidential determination that the price and supply of petroleum and petroleum products produced in countries other than Iran is sufficient to permit purchasers of petroleum and petroleum products from Iran to reduce significantly their purchases from Iran is in effect under Section 1245(d)(4)(B) of the 2012 NDAA.

Even if such a determination is in effect, the exportation of petroleum or petroleum products from Iran to a country is not sanctionable if, at the time of the exportation, a Presidential determination that the country has significantly reduced its crude oil purchases from Iran pursuant to Section 1245(d)(4)(D)(i) of the 2012 NDAA is in effect (subject to the additional conditions on financial transactions set forth below).

With respect to a financial transaction conducted or facilitated by a foreign financial institution for the sale, supply or transfer to or from Iran of significant goods or services used in connection with the energy, shipping or shipbuilding sectors of Iran, the financial transaction is not sanctionable if (i) the transaction is not otherwise subject to U.S. sanctions, (ii) the transaction is only for trade in goods or services between Iran and the country with primary jurisdiction over the foreign financial institution, (iii) any funds owed to Iran as a result of such trade are credited to an account located in the country with primary jurisdiction over the foreign financial institution, and (iv) a Presidential determination pursuant to Section 1245(d)(4)(D)(i) (as described above) is in effect.

⁶ Sanctions and exemptions for foreign financial institution facilitation are discussed below.

⁷ The SDN List is available at <http://www.treasury.gov/resource-center/sanctions/SDN-List/Pages/default.aspx>.

Afghanistan reconstruction or economic development described above also apply to this provision.

Note that this directive is much broader than the energy, shipping and shipbuilding sanctions; the terms are quite sweeping on their face and would encompass virtually any interaction with any Iranian SDN. However, as the provision requires additional action by the Administration to designate entities for dealings with or on behalf of or for the benefit of Iranian SDNs, it remains to be seen how broadly the authority to sanction will be applied in practice.

Precious Metals, Raw or Semi-Finished Metals, Coal, Graphite and Certain Industrial Software. Section 1245 of the IFCPA directs the President to impose at least five of the twelve ISA sanctions on any person that he determines knowingly sells, supplies or transfers, directly or indirectly, to or from Iran precious metals, graphite, raw or semi-finished metals (e.g., aluminum and steel), coal and “software for integrating industrial processes” under certain circumstances.⁸ Sanctions could be applied in every case with respect to precious metals; with respect to the other described materials (including software), however, sanctions could be applied only if:

- The President determines that (i) Iran is using the material as a medium for barter, swap or any other exchange or transaction; (ii) Iran is listing the material as an asset for purposes of its national balance sheet; or (iii) the material is used in connection with the nuclear, military or ballistic missile programs of Iran; or
- The material is (i) to be used in connection with the energy, shipping or shipbuilding sectors of Iran or any other sector of the economy of Iran determined by the President to be controlled directly or indirectly by Iran’s Revolutionary Guard Corps; (ii) sold, supplied or transferred to or from an Iranian person on the SDN List (other than Iranian financial institutions that are not designated under the IFSR); or (iii) resold, retransferred or otherwise supplied (a) to an end-user in a sector described in (i), (b) to a person described in (ii), or (c) for the nuclear, military or ballistic missile programs of Iran.

Section 1245 of the Act exempts from sanctions any person that the President determines has exercised due diligence in establishing and enforcing official policies, procedures and controls to ensure the person does not engage in activities sanctionable under Section 1245. However, this is an after-the-fact determination, and so companies cannot be certain that their diligence procedures will be deemed adequate in hindsight. Moreover, it is unclear whether “knowingly” modifies only “sells, supplies, or transfers, directly or indirectly, to or from Iran,” or if it also modifies the conditions describing the prohibited uses of the materials. As a practical matter, these provisions mean that there may be exposure for any supplier providing materials that ultimately pass to a restricted end user or sector. As noted below, insurance coverage may also be unavailable.

⁸ “Software for integrating industrial processes” is also not defined in the statute.

Facilitation by Foreign Financial Institutions. Under Sections 1244 and 1247 of the IFCPA,⁹ a foreign financial institution will be subject to the imposition of sanctions eliminating or restricting access to U.S. correspondent accounts, as under the IFSR, if the President determines that the institution knowingly conducts or facilitates a significant financial transaction:

- For the sale, supply or transfer to or from Iran of significant goods or services used in connection with the energy, shipping or shipbuilding sectors of Iran (not defined); or
- On behalf of any Iranian person on the SDN List (other than Iranian financial institutions that are not designated under the IFSR).

The conduct or facilitation of certain financial transactions by foreign financial institutions is exempt from sanctions under Section 1244 and 1247:

- Financial transactions with respect to trade between an oil importing country and Iran, subject to largely the same conditions as included in the 2012 NDAA;¹⁰
- Financial transactions for the sale, supply or transfer to or from Iran of natural gas, if (i) the financial transaction is only for trade in goods or services (a) not otherwise subject to sanctions under the law of the United States and (b) between the country with primary jurisdiction over the foreign financial institution and Iran, and (ii) any funds owed to Iran as a result of such trade are credited to an account located in the country with primary jurisdiction over the foreign financial institution (*i.e.*, conditions parallel to those under the 2012 NDAA applicable to petroleum sales); and
- Financial transactions for sales of agricultural commodities, food, medicine or medical devices to Iran or for humanitarian assistance to the people of Iran (this exemption is not available for transactions that are sanctionable under Section 1245 of the IFCPA).

Under Section 1245(c) of the IFCPA, a foreign financial institution will be subject to the imposition of correspondent account sanctions if it knowingly conducts or facilitates a significant financial transaction for the sale, supply or transfer to or from Iran of materials sanctionable under Section 1245. There is again an exemption if the President determines that the foreign financial institution has exercised due diligence in establishing and enforcing official policies, procedures and controls to ensure that it does not conduct or facilitate such a financial transaction, but no other exemption (including the 2012 NDAA petroleum trade exemption) applies.

In all cases, if sanctions are imposed, the foreign financial institution will be prohibited from opening, and prohibited or subjected to strict restrictions on maintaining, a

⁹ IFCPA §§ 1244(d)(2), 1247.

¹⁰ See note 5, above.

correspondent or payable-through account in the United States, thereby effectively closing off its access to the U.S. financial system, including U.S.-dollar clearing transactions.

Underwriting, Insurance and Reinsurance Activities. Section 1246 of the IFCPA directs the President to impose five or more of the twelve ISA sanctions on any person that he determines knowingly provides underwriting services, insurance or reinsurance for or to the following activities and persons:

- Any Iran-related activity for which sanctions have been imposed under the IFCPA, the International Emergency Economic Powers Act (the “IEEPA”), the ISA, the Comprehensive Iran Sanctions, Accountability and Divestment Act of 2010 (“CISADA”),¹¹ the ITRA or any other provision of law related to sanctions on Iran;
- Any person for the benefit of or related to any activity connected with the energy, shipping or shipbuilding sectors of Iran for which sanctions are imposed under Section 1244 of the Act (as described above);
- Any person for the sale, supply or transfer to or from Iran of materials (other than precious metals) for which sanctions are imposed under Section 1245 of the Act (as described above);
- Any person designated for sanctions under the IEEPA in connection with Iran’s proliferation of weapons of mass destruction or support of international terrorism; and
- Any Iranian person on OFAC’s SDN List (other than Iranian financial institutions that are not designated under the IFSR).

The language of this section is highly ambiguous. “For which sanctions have been imposed” appears on first reading to require that the particular insured activity has resulted in the imposition of sanctions. However, such a reading risks making nonsense of the section, since insurance is prospective and sanctions are retrospective—one could not knowingly insure an activity that had been specifically sanctioned if that activity had already taken place. It thus appears possible that insuring any activity for which U.S. law provides for sanctions could result in the imposition of sanctions on the insurer.

As with Section 1245, Section 1246 provides an exemption from sanctions for any person that the President determines has exercised due diligence in establishing and enforcing official policies, procedures and controls to ensure the person does not engage in activities sanctionable under Section 1246.

Effective Date. The sanctions described above may first be imposed on July 1, 2013, 180 days after enactment of the IFCPA.

¹¹ For additional detail on CISADA, please see our July 6, 2010, memorandum, available at http://www.cgsh.com/president_obama_signs_new_iran_sanctions_into_law/.

Amendments to the 2012 NDAA. Effective immediately, the IFCPA amends the 2012 NDAA to require the President, in connection with any waiver granted to a foreign financial institution for transactions with the Central Bank of Iran or other designated Iranian financial institutions, to certify to Congress that the country with primary jurisdiction over the foreign financial institution otherwise subject to the sanctions faced “exceptional circumstances” that prevented the country from being able to reduce significantly its purchases of petroleum and petroleum products from Iran.¹² This appears designed to make it somewhat more difficult, but not impossible, for the President to provide waivers to a country’s banks if that country has not been able to reduce its petroleum imports from Iran (and therefore is ineligible for the exemption in Section 1245(d)(4)(D) of the 2012 NDAA for countries that have significantly reduced crude oil purchases from Iran).¹³

Other Notable Provisions. The IFCPA requires the President to impose sanctions on the Islamic Republic of Iran Broadcasting and the President of the Islamic Republic of Iran Broadcasting, Ezzatollah Zargami, and to designate both on the SDN List.¹⁴ It also requires the President to impose sanctions on persons engaged in corruption or other activities relating to (i) the diversion of goods, including agricultural commodities, food, medicine and medical devices, intended for the people of Iran; or (ii) the misappropriation of proceeds from the sale or resale of such goods.¹⁵ Each of these provisions is effective immediately.

Key ITSR Amendments

The most significant amendments to the ITSR made on December 26 provide additional detail to the provisions of Executive Order 13628, which implemented ITRA’s requirement to prohibit U.S.-Owned Entities from knowingly engaging in transactions with Iran or Iranian persons that would be prohibited for a U.S. person. Under these new provisions, an entity is “owned or controlled” by a U.S. person if a U.S. person (i) holds a 50 percent or greater equity interest as measured by votes or value in the entity; (ii) holds a majority of seats on the board of directors of the entity; or (iii) otherwise controls the actions, policies or personnel decisions of the entity. In addition to applying the general ITSR prohibitions to U.S.-Owned Entities, the amendments also authorize U.S.-Owned Entities to rely on any general licenses available for U.S. persons under the ITSR that would authorize the activity if carried out by a U.S. person or in the United States.

Amendments to a number of general licenses make it clear that the general licenses do not apply to U.S.-Owned Entities if the transaction is prohibited by other OFAC

¹² IFCPA § 1250 (amending Section 1245(d)(5) of the 2012 NDAA).

¹³ Previously, Section 1245(d)(5) of the 2012 NDAA permitted the President to grant a temporary waiver based upon a determination that the waiver was in the national security interest of the United States, so long as the President provided a report to Congress that provided a justification for the waiver and included any concrete cooperation the President had received or expected to receive as a result of the waiver.

¹⁴ IFCPA § 1248.

¹⁵ Id. § 1249.

regulations (e.g., the Global Terrorism Sanctions Regulations, which apply to a number of Iranian entities) as well as the ITSR. In addition, some ambiguity remains with respect to general licenses that specifically apply only to transactions with the United States (for example, a U.S. person may engage in transactions to move household goods from the United States to Iran; a U.S.-controlled German entity could also move household goods from the U.S. to Iran, but it is unclear whether it could move household goods from Germany to Iran).

The amendments provide a general license until March 8, 2013, for transactions incident and necessary to the winding down of transactions newly prohibited for U.S.-Owned Entities, so long as such transactions do not involve a U.S. person or occur in the United States, do not involve IFSR-designated Iranian financial institutions, and certain other conditions. Pursuant to the ITRA, the amendments create a civil penalty enforcement mechanism against the U.S. persons that own or control a U.S.-Owned Entity if the U.S.-Owned Entity violates the ITSR; U.S. persons can avoid penalties under this provision if they divest or terminate such investments or business with the U.S.-Owned Entity as is necessary to no longer be deemed to "own or control" the entity by February 6, 2013.

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If you have any questions, please feel free to contact any of your regular contacts at the Firm, or Ken Bachman or Paul Marquardt of our Washington office, listed on our website at <http://www.clearygottlieb.com>.

CLEARY GOTTLIEB STEEN & HAMILTON LLP

NEW YORK

One Liberty Plaza
New York, NY 10006-1470
T: +1 212 225 2000
F: +1 212 225 3999

WASHINGTON

2000 Pennsylvania Avenue, NW
Washington, DC 20006-1801
T: +1 202 974 1500
F: +1 202 974 1999

PARIS

12, rue de Tilsitt
75008 Paris, France
T: +33 1 40 74 68 00
F: +33 1 40 74 68 88

BRUSSELS

Rue de la Loi 57
1040 Brussels, Belgium
T: +32 2 287 2000
F: +32 2 231 1661

LONDON

City Place House
55 Basinghall Street
London EC2V 5EH, England
T: +44 20 7614 2200
F: +44 20 7600 1698

MOSCOW

Cleary Gottlieb Steen & Hamilton LLC
Paveletskaya Square 2/3
Moscow, Russia 115054
T: +7 495 660 8500
F: +7 495 660 8505

FRANKFURT

Main Tower
Neue Mainzer Strasse 52
60311 Frankfurt am Main, Germany
T: +49 69 97103 0
F: +49 69 97103 199

COLOGNE

Theodor-Heuss-Ring 9
50688 Cologne, Germany
T: +49 221 80040 0
F: +49 221 80040 199

ROME

Piazza di Spagna 15
00187 Rome, Italy
T: +39 06 69 52 21
F: +39 06 69 20 06 65

MILAN

Via San Paolo 7
20121 Milan, Italy
T: +39 02 72 60 81
F: +39 02 86 98 44 40

HONG KONG

Cleary Gottlieb Steen & Hamilton (Hong Kong)
Bank of China Tower, 39th Floor
One Garden Road
Hong Kong
T: +852 2521 4122
F: +852 2845 9026

BEIJING

Twin Towers – West (23rd Floor)
12 B Jianguomen Wai Da Jie
Chaoyang District
Beijing 100022, China
T: +86 10 5920 1000
F: +86 10 5879 3902

BUENOS AIRES

CGSH International Legal Services, LLP-
Sucursal Argentina
Avda. Quintana 529, 4to piso
1129 Ciudad Autonoma de Buenos Aires
Argentina
T: +54 11 5556 8900
F: +54 11 5556 8999

SÃO PAULO

Cleary Gottlieb Steen & Hamilton
Consultores em Direito Estrangeiro
Rua Funchal, 418, 13 Andar
São Paulo, SP Brazil 04551-060
T: +55 11 2196 7200
F: +55 11 2196 7299

ABU DHABI

Al Odaid Tower
Office 1105, 11th Floor
Airport Road; PO Box 128161
Abu Dhabi, United Arab Emirates
T: +971 2 414 6628
F: +971 2 414 6600

SEOUL

Cleary Gottlieb Steen & Hamilton LLP
Foreign Legal Consultant Office
19F, Ferrum Tower
19, Eulji-ro 5-gil, Jung-gu
Seoul 100-210, Korea
T: +82 2 6353 8000
F: +82 2 6353 8099