

GLOBAL SUPPLY CHAIN REVIEW

Published by the Global Supply Chain Leaders Group
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Vivek Kamath
Vice President - Supply Chain Operations
Raytheon Company

New Iran Sanctions Impose Stringent Restrictions

By Charles G. Berry and Michael E. Ginsberg

Background

On July 1, 2010, President Obama signed the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (CISADA). This new law amends and extends existing sanctions under the Iran Sanctions Act of 1996 (ISA). It imposes significant restrictions on the ability of U.S. and foreign companies to provide to Iran refined petroleum products, such as gasoline and equipment used in the refined petroleum industry. These sanctions have already had a significant effect on the activities of international shipping and logistics companies.

U.S. sanctions on Iran, and on its petroleum industry, are not new. Since 1996 the ISA has prohibited U.S. persons (for the most part, U.S. citizens and permanent residents) from engaging in a wide array of transactions with Iran. Prior to the enactment of CISADA, U.S. regulations already prohibited U.S. companies from entering into transactions for the overall management or financing of petroleum development projects in Iran.

The new sanctions go a step further, and their greatest effect will likely be on non-U.S. companies not previously covered by U.S. sanctions. International shipping companies, brokers, insurers and others involved in international trade and services are subject to harsh new sanctions under CISADA. Many of the new sanctions, including the refined petroleum sanctions, are intended to apply to companies all over the world, even those without any U.S. offices, business activities or other ties here.

The New U.S. Sanctions on Iran

Most relevant to companies involved in international trade are the new sanctions on refined petroleum products. CISADA imposes sanctions on U.S. and non-U.S. companies for four particular activities involving refined petroleum products:

- investing more than \$20 million in the Iranian petroleum industry in any given investment, and working individual investments of \$5 million or more over the course of a 12-month period. An “investment” is defined as one that directly and significantly enhances Iran's ability to develop petroleum resources.
- providing goods, services or other support that directly or significantly facilitates the maintenance or expansion of Iran's domestic production of refined petroleum products. That includes any direct and significant help in constructing, modernizing or repairing petroleum refineries, in amounts of \$1 million or more for any individual provision of goods or services, or an aggregate of \$5,000,000 or more over a 12-month period.
- providing Iran with refined petroleum products worth \$1 million or more or an aggregate of \$5 million or more over a 12-month period.
- providing Iran with goods, services, technology or other items directly or significantly enhancing Iran's ability to import refined petroleum products, where those goods or services have a value of \$1 million or more or an aggregate value of \$5 million or more over a 12-month period.

Because the new sanctions do not define the term “directly and significantly,” companies should be prepared for the possibility that the U.S. government will interpret broadly what constitutes a “direct and significant” product, service or enhancement of Iran's refined petroleum capabilities.

Of particular importance to the international trade community is the new law's description of the prohibited services. Services that enhance Iran's ability to import refined petroleum include “providing insurance for the sale, lease, or provision of goods, services, technology, or other support; financing or brokering such sales or leases; and providing ships or services to deliver refined petroleum products to Iran.” This is a

broad definition of “services” and covers a wide array of activities involving shipping related to refined petroleum and Iran. A single exception permits the President to refrain from imposing sanctions on a person providing underwriting services, insurance or reinsurance if he finds that such person has exercised diligence in establishing policies and procedures to avoid prohibited activity.

The new law also requires the President to initiate an investigation upon receipt by the U.S. of “credible information” indicating that a person is engaged in sanctionable activity. Within 180 days, the President is required to determine if such person is involved in sanctionable activity and notify Congress of the basis for that determination. The new law also requires the President to certify that any waivers granted are “necessary to the national interest.” That is a higher standard than the standard of “important to the national interest” in the ISA.

For companies providing services to U.S. government, the new sanctions impose particular requirements and present potential risks. All prospective U.S. government contractors must certify that they and each person they own or control are not engaging in any sanctionable activity. A false certification to the government, whether deliberate or inadvertent, could result in sanctions on the prospective contractor, including prohibitions on contracting with the U.S. government and the loss of existing U.S. government contracts.

For sanctionable activity involving (1) the production of refined petroleum products in Iran or (2) the exportation of such products to Iran, the requirement to commence an investigation is delayed for one year and can be extended for renewable six-month periods if the President certifies that there was a substantial reduction in sanctionable activities under those provisions. If no certification is made, an investigation must commence when the certification would have been due, and a determination is due in 45 days.

The purpose of these sanctions is clear: to deny Iran access to refined petroleum products and to prevent Iran from enhancing its existing petroleum refining capability. As Iran imports a significant fraction of its gasoline, the U.S. government believes these sanctions will affect Iran's willingness to negotiate over its nuclear program.

Potential Penalties

If the President determines that an individual or company has engaged in sanctionable activity and no waiver applies, at least three out of a possible nine sanctions must be imposed. The potential sanctions are:

- disqualification from U.S. Export-Import Bank assistance;
- denial of U.S. export licenses;
- prohibition on loans totaling more than \$10 million in any 12-month period from U.S. financial institutions;
- prohibition as a primary dealer in U.S. Government debt instrument; or repository of U.S. Government funds (if a financial institution);
- prohibition on U.S. Government procurement;
- restriction on U.S. imports from the sanctioned person;
- prohibition on any transactions in foreign exchange subject to U.S. jurisdiction;

- prohibition on any transfers of credit or payments between, by, through, or to any financial institution subject to U.S. jurisdiction that involve any interest of the sanctioned person; and
- prohibition on acquiring, holding, withholding, using, transferring, withdrawing, transporting, importing, exporting or conducting any transaction involving any property subject to U.S. jurisdiction to which the sanctioned person has any interest.

What Do the New Sanctions Mean for My Company?

Companies in the international trading business - such as shipping companies, logistics specialists, freight forwarders, insurers, and the like - should pay careful attention to these sanctions. Activities that were once routine now carry risk. Companies in the business of servicing transport aircraft or ships are at risk of sanctions if they provide fuel to aircraft or ships bound for Iran or owned by Iranian interests, including the Iranian government. Service companies are at risk of being sanctioned if they provide services to any aircraft, ship or vehicle carrying refined petroleum or equipment related to petroleum refining to Iran. Insurance companies are at risk if they insure any vessel bound for Iran carrying refined petroleum or petroleum refining equipment.

Transportation and shipping companies need to be extremely careful to ensure that the cargo they carry does not include refined petroleum or petroleum refining equipment destined for Iran. International investors risk being sanctioned for making investments in the development of petroleum refining capabilities in Iran. States and localities instituting divestment policies for their portfolios have broad discretion in determining whether a company is involved in the Iranian petroleum refining or energy sector. Companies investing in industrial activities in Iran related to the energy sector also risk being sanctioned.

If you are a U.S. government contractor or planning to bid on a U.S. government contract in the future, you must be certain when certifying to the U.S. government that you are in compliance with the U.S. sanctions that you and all of your subsidiaries are compliant with the U.S. law. Even an unintentional error on a certification may warrant a sanction.

The Response to the New Iran Sanctions

Given the breadth of CISADA, the severity of its penalties and ambiguities in its language, companies engaging in international trade that may involve Iran are at significant risk of sanctions. These new sanctions apply even to non-U.S. companies: in fact, those companies were expressly targeted. At least BP, Total, and Shell have ceased supplying gasoline or fuel with Iran as a result of the enhanced sanctions and the general climate they have created. BP, for example, is reported to have refused to refuel passenger jets of the Iranian national carrier at London's Heathrow Airport. It is expected that other international oil companies will follow suit. In addition, Toyota recently announced that it is suspending shipments of automobiles to Iran.

Another major concern for any company involved with international trade in light of the new sanctions is the possibility of negative publicity associated with any activities involving refined petroleum and Iran. The U.S. Congress strongly supported the new sanctions on a bipartisan basis. In addition, members of Congress from both parties have recently announced the creation of a bipartisan "Working Group on Iran Sanctions Implementation" to support full implementation of the sanctions, and they plan to hold hearings in the fall. Given the high interest in the sanctions and their enforcement by both political parties, companies that violate the sanctions or undertake activities involving refined petroleum and Iran are likely to find themselves the subject of unwanted negative publicity and even hearings in Congress.

The state and local government divestment provisions of the CISADA may also begin to affect overseas businesses. Many states have passed statutes requiring state pension funds and other investment funds to divest holdings in companies operating in Iran's petroleum sector. With passage of the new federal sanctions, other states may follow suit. Local governments, and some U.S. private institutions including

certain universities, have enacted similar divestment laws or policies. Interest groups, including human rights groups, may use these sanctions to put public pressure on non-U.S. companies doing business in Iran. International trading companies perceived to be involved in Iranian refined petroleum exports may face such divestment by U.S. states and localities.

How these sanctions play out over the long run - and particularly how strongly the U.S. government ultimately enforces them - is unclear. What is clear is that numerous international companies have decided the safer course is to cease transactions in the Iranian energy sector altogether - a result no doubt welcome to and intended by the U.S. government.

About the Authors:

Charles Berry is a litigation partner in Arnold & Porter LLP's New York office. He has handled a broad range of commercial litigation in federal and state courts for more than 30 years, with a particular emphasis on representation of foreign banks and businesses with international operations. He has also advised banks and shipping agencies concerning compliance with OFAC regulations and U.S. trade sanctions, including the recent enhancements to the Iran sanctions.

Mike Ginsberg is an associate in Arnold & Porter LLP's Washington DC office in the firm's government contracts/public policy and intellectual property/technology practices. He focuses on export controls, trade sanctions and compliance, and intellectual property and technology-related litigation. He advises companies regarding compliance with US export control laws and trade sanctions. He also has experience in commercial litigation and patent litigation/counseling involving a wide array of technologies. Mr. Ginsberg previously served as the Senior Advisor to the Assistant Secretary for Export Enforcement at the Bureau of Industry and Security of the US Department of Commerce.