

Reproduced with permission from Federal Contracts Report, 94FCR 621, 12/28/2010. Copyright © 2010 by The Bureau of National Affairs, Inc. (800-372-1033) <http://www.bna.com>

Sanctions

Expanded Sanctions Against Iran Cut Across Multiple Sectors; New Certification and Compliance Requirements Affect Federal Contractors



BY STEVEN DIAMOND, SAMUEL WITTEN, AND
MATTHEW PHILLIPS

U.S. sanctions against Iran were expanded significantly in the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (CISADA), signed into law by President Obama on July 1, 2010.¹ The new sanctions particularly target Iran's energy and banking sectors, both considered areas where the United States can exert significant pressure on the Iranian regime. The Treasury Department has issued broad new regulations to implement the sanc-

¹ CISADA § 1, Pub. L. No. 111-195, 124 Stat. 1312 (to be codified in scattered sections of the U.S.C.).

Steven Diamond is a senior partner in the Washington, DC office of Arnold & Porter LLP. He can be reached at 202.942.5223 or Steven.Diamond@aporter.com. Samuel Witten is counsel in the Washington, DC office of Arnold & Porter LLP. He can be reached at 202.942.6115 or Samuel.Witten@aporter.com. Matthew Phillips is an associate in the Washington, DC office of Arnold & Porter LLP. He can be reached at 202.942.6838 or Matthew.Phillips@aporter.com.

tions² and the Obama Administration has made clear its intention to enforce sanctions vigorously and to consider new sanctions if deemed necessary.³

The new law has significant implications for prospective U.S. government contractors. It requires prospective federal contractors to meet new certification requirements relating to Iran sanctions, and also prohibits U.S. government agencies from contracting with any entity—foreign or domestic—that exports certain technology to Iran. The Federal Acquisition Regulation was amended on an interim basis as of September 29, 2010, to implement CISADA's new rules on federal contractors.⁴ Final acquisition rules are expected to be issued in the near future.

This article begins by providing a general overview of the new sanctions against Iran. It identifies the particular sectors most affected by the amendments and discusses the specific sanctions applicable to those sectors. It next discusses the expansion of sanctions available under U.S. law and discusses procedural enhancements and increased penalties under the new law.

Next, the article outlines the restrictions imposed on prospective U.S. contractors under the law and the current interim implementing regulations in the FAR. It explains the legal framework under which each prospective contractor submitting a bid to the federal government must certify that the offeror "any person owned or controlled" by the offeror does not conduct any activity for which Iran sanctions may be imposed. It then explains the actions that are required if a federal agency determines that an offeror falsely certified that

² 31 C.F.R. § 560 (2010).

³ See *Implementing Tougher Sanctions on Iran: A Progress Report*, 111th Cong. (2010) (statements of Hon. William J. Burns, Under Secretary for Political Affairs, U.S. Department of State; and Hon. Stuart A. Levey, Under Secretary for Terrorism and Financial Intelligence, U.S. Department of Treasury).

⁴ Federal Acquisition Regulation; Certification Requirement and Procurement Prohibition Relating to Iran Sanctions, 75 Fed. Reg. 60,254-60,258 (Sept. 29, 2010) (codified at 48 C.F.R. §§ 4, 25, 52).

it or any person it owns or controls does not engage in sanctionable conduct. Finally, it notes the rules whereby an agency or contractor can seek a waiver to the certification requirement by submitting a request through the Office of Federal Procurement Policy. As noted above, the current FAR provisions are interim and may be subject to amendment based on comments received during the rulemaking process.

Overview of Amendments to U.S. Law under CISADA. The new Iran sanctions in CISADA, which amended and extended the existing Iran sanctions under the Iran Sanctions Act of 1996 (ISA),⁵ are intended to put further pressure on the Iranian regime in the wake of continued tension over Iran's nuclear program and human rights violations related to the June 2009 presidential election in Iran. Overall, the new law will impact more non-U.S. companies, create new tougher sanctions focused on the petroleum refining and financial sectors, and force the Obama Administration to conduct more investigations of potential violations and to justify to Congress any decision not to impose sanctions.

This legislation will have its greatest effect on many companies and financial institutions whose activities had not previously been subject to U.S. sanctions legislation. U.S. companies, U.S. persons wherever located, and anyone actually in the United States were already subject to comprehensive sanctions enforced by the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC), and certain non-U.S. companies were already subject to some sanctions under the ISA. But more foreign companies, including shipping companies, international brokers, insurers, and other companies involved in international trade, as well as more foreign subsidiaries of U.S. companies, will face harsh new sanctions under CISADA. For example, a foreign insurance or shipping company could face U.S. sanctions under the new law for business operations entirely outside the United States, even if they do not have any offices or employees in the United States. Enforcement of this extraterritorial jurisdiction is likely to create foreign policy tensions for the Administration.

Petroleum Industry Sanctions. The new sanctions require the president to impose three or more of the sanctions available under the ISA on any individual or entity, domestic or foreign, that "knowingly" makes an investment of U.S. \$20 million or more in the Iranian petroleum industry, or makes individual investments of U.S. \$5 million or more in the Iranian petroleum industry that add up to U.S. \$20 million over the course of a 12-month period.⁶ This expands the existing law, which only requires imposition of two sanctions for such violations. The investments must "directly and significantly" contribute to the Iranian petroleum industry. CISADA does not define the term "directly and specifically," thereby leaving that term open to interpretation. CISADA does define "knowingly" to mean that a person must have actual knowledge or a reason to know of the investment or other conduct prohibited by CISADA.⁷

The new law also expands the scope of the ISA to cover the petroleum refining industry and refined pet-

roleum products. CISADA requires the president to impose three or more of the ISA sanctions on any individual or entity, domestic or foreign, that knowingly provides goods or services valued at U.S. \$1 million or more, or U.S. \$5 million in total over a 12-month period, to support the Iranian petroleum refining industry. The prohibited goods and services include construction, modernization, and repair of refineries and refinery equipment.⁸

Finally, CISADA requires the president to impose sanctions on any domestic or foreign person who knowingly sells or otherwise provides refined petroleum products to Iran valued at U.S. \$1 million in any individual transaction, or U.S. \$5 million over the course of a 12-month period. The president must also impose sanctions on any company providing goods or services valued at U.S. \$1 million in any individual transaction, or U.S. \$5 million over the course of a 12-month period, that enhance Iran's ability to import refined petroleum products. These services include shipping refined petroleum to Iran or financing, brokering, underwriting, or insuring shipments of refined petroleum to Iran.⁹

It is particularly important to note that the petroleum-related sanctions apply to both foreign and domestic entities. Non-U.S. companies may be sanctioned, even if they do not have any offices or employees in the United States. Non-U.S. companies currently doing petroleum business in Iran must therefore either terminate business activities in Iran or continue conducting business in Iran and risk sanctions in the United States. CISADA does provide additional presidential waiver authority for specific companies located in countries that the United States considers to be "closely cooperating" with the United States in multilateral efforts to prevent Iran's acquisition of weapons of mass destruction.¹⁰

However, it may be hard for countries to be classified as closely cooperating. The president cannot unilaterally waive sanctions on an entity or all entities from an individual country. Before waiving sanctions on a particular company, the president must certify to Congress that the company's home country is closely cooperating with the United States in preventing Iran's acquisition of weapons of mass destruction, provide a description of how that country is cooperating, and certify that the waiver is vital to U.S. national security.¹¹ These presidential waivers can last no more than one year; the president can renew the waiver for six-month periods by following the same process as for the original waiver.¹²

Expansion of Sanctions Available Under the ISA. CISADA adds three new sanctions to the panoply of available sanctions under the ISA. First, a sanctioned entity may be prohibited from any foreign exchange transactions that fall within U.S. jurisdiction, and in which the sanctioned party has any interest. The president may also prohibit transfers of credit or payments in which the sanctioned party has an interest between financial institutions, to the extent those transactions are subject to U.S. jurisdiction. Finally, CISADA permits the president to prohibit a sanctioned entity from acquiring, holding, importing, or exporting any prop-

⁵ Iran and Libya Sanctions Act of 1996, Pub. L. No. 104-172, 110 Stat. 1541 (codified at 50 U.S.C. § 1701).

⁶ CISADA § 102(a).

⁷ *Id.* § 101.

⁸ *Id.* § 102(a).

⁹ *Id.*

¹⁰ *Id.* § 102(g).

¹¹ *Id.*

¹² *Id.*

erty subject to U.S. jurisdiction or engaging in other transactions involving such property.¹³ The United States has already imposed sanctions under CISADA against one firm, and has opened formal investigations into the activities of other firms.¹⁴

Sanctions on International Banks. CISADA also subjects non-U.S. banks that engage in or facilitate transactions involving certain Iranian entities and activities to significant new sanctions. Non-U.S. banks that support or service the Iranian Revolutionary Guard and its affiliates, or facilitate transactions relating to the Iranian government's efforts to acquire weapons of mass destruction or its support of terrorism may be prohibited or severely restricted by the U.S. Treasury Department from participating in the U.S. banking system.¹⁵ Specifically, the new sanctions permit the Treasury Department to prohibit or impose strict conditions on the ability of sanctioned non-U.S. banks to open or maintain a correspondent account or payable-through account in a U.S. bank.

U.S. banks that maintain accounts for non-U.S. banks will be required under the new law to audit the non-U.S. banks' activities and certify that they are not performing services for the Iranian Revolutionary Guard or related entities, or facilitating transactions related to Iranian efforts to acquire weapons of mass destruction or to support terrorist activities. The U.S. banks must report the results of these audits to the Treasury Department.¹⁶

Increases in Criminal Penalties for Export and Sanctions Violations

CISADA increases the criminal penalties for any violations of the Arms Export Control Act (AECA) (not just those involving Iran) to a maximum 20 years' imprison-

ment, an increase over the previous maximum of 10 years' imprisonment; the maximum fine was not changed and remains U.S. \$1 million per violation. AECA governs the export of munitions items appearing on the U.S. Munitions List and subject to the International Traffic in Arms Regulations (ITAR). The new law also increases the criminal penalty for violations of the prohibition on exporting or otherwise providing munitions items to countries that have been determined to support international terrorism from 10 to 20 years' imprisonment; the maximum fine amount remains U.S. \$1 million. The criminal penalty for violations of the Trading with the Enemy Act by individuals was also increased, to 20 years' imprisonment from 10 years' imprisonment; the maximum fine for individuals remains U.S. \$100,000. Finally, CISADA increases penalties for violations of regulations implementing United Nations sanctions to 20 years' imprisonment and U.S. \$1 million in fines, from 10 years' imprisonment and U.S. \$10,000 in fines.¹⁷

Creation of the Destination of Diversion Concern List. The CISADA creates a mechanism to identify countries to be placed on a "Destination of Diversion Concern" list. A country is to be designated a "destination of diversion concern" if that country is identified as allowing substantial diversion to Iranian end-users or intermediaries of U.S. origin items that would materially contribute to Iran's weapons or missile programs or terrorism activities, and that are listed on the State Department's U.S. Munitions List or the Commerce Department's Commerce Control List. Exports of all such items require a license to countries designated as Destinations of Diversion Concern, and U.S. government export licensing agencies will operate under a presumption of denial for any export license application for such items.¹⁸

Procedural Changes to Strengthen Enforcement. The new law makes important procedural changes designed to strengthen how the executive branch implements the sanctions on Iran. CISADA requires the president to initiate an investigation when the U.S. has credible information indicating that a person may have violated the Act, unlike the existing law which does not mandate such investigations. The new law also mandates that the president must make a determination within 180 days after commencing an investigation and must notify the designated congressional committees.¹⁹ These relatively simple changes will force the Department of State, which Congress had previously accused of being lax in its enforcement of the ISA, to conduct investigations of transactions reported in the press (or elsewhere) and to give reasons for not imposing sanctions. The new law also requires the president to certify that any waivers granted are "necessary to the national interest," which is a higher standard than the standard of

¹³ *Id.* § 102(b). On August 16, 2010, the Treasury Department's Office of Foreign Assets Control (OFAC) issued new Iranian Financial Sanctions Regulations (IFSR) to the provisions of CISADA. 31 C.F.R. § 560 (2010). The new regulations primarily track the statutory provisions, and also provide important additional guidance regarding which transactions with proscribed Iranian entities may be considered "significant transactions" that would trigger the imposition of sanctions. The Treasury Department may prohibit or severely restrict foreign financial institutions that "knowingly" violate the statute or regulations from participating in the U.S. banking system. Foreign financial institutions will need to exercise extreme caution in their transactions with Iranian entities to avoid violating the IFSR and should maintain robust due diligence programs. The Treasury Department regulations are discussed at http://www.arnoldporter.com/resources/documents/Advisory_Treasury_Department_Releases_New_Iran_Financial_Sanctions_Regulations_82410.pdf.

¹⁴ See *Implementing Tougher Sanctions on Iran: A Progress Report*, 111th Cong. (2010) (statement of Hon. William J. Burns, Under Secretary for Political Affairs, U.S. Department of State) ("We are enforcing the law rigorously and energetically. Already, more foreign investment in Iran has been curbed than at any time since Congress enacted the original Iran Sanctions Act nearly fifteen years ago.").

¹⁵ CISADA § 104(c).

¹⁶ *Id.* § 102(e). The new legislation also directs the president to submit a list of names of Iranian government officials (or persons acting on their behalf) identified as being responsible for or complicit in the human rights violations that occurred in the aftermath of the June 2009 Iranian presidential election. The sanctions on these identified individuals include ineligibility for visas to enter the United States, blocking of property subject to U.S. jurisdiction, and restrictions on financial transactions and imports within U.S. jurisdiction. *Id.* § 105

¹⁷ *Id.* § 107.

¹⁸ *Id.* §§ 302-03.

¹⁹ CISADA designates the following congressional committees: the Committee on Armed Services of the Senate; the Committee on Finance of the Senate; the Committee on Banking, Housing, and Urban Affairs of the Senate; the Committee on Foreign Relations of the Senate; the Committee on Armed Services of the House of Representatives; the Committee on Ways and Means of the House of Representatives; the Committee on Financial Services of the House of Representatives; and the Committee on Foreign Affairs of the House of Representatives. *Id.* § 101.

“important to the national interest” in the previous Iran Sanctions Act.

Other CISADA Provisions. The new legislation extends the sanctions regime of the ISA, as amended by the CISADA, through December 31, 2016.²⁰ In addition to the various sanctions provisions, the new legislation provides a framework permitting states and localities to divest from Iran. Overall, the sanctions imposed by CISADA represent a tightening of the United States’ existing Iran sanctions regime. While the new sanctions are focused on the petroleum and financial sectors, all companies doing business in Iran should be familiar with the scope of the new sanctions. Companies outside the United States that do business with Iran must consider the implications of these sanctions, as the sanctions apply to foreign companies. The activities of shipping companies, international brokers, insurers, and other companies involved in international trade are covered by these sanctions.

Amendments to Federal Acquisition Regulation. Companies, whether domestic or foreign, bidding on U.S. government procurements, must certify under the new law that they do not engage in any activity regarding Iran that is prohibited by the ISA and CISADA.²¹ False certifications can result in termination of ongoing contracts and federal contract suspension and debarment for up to three years.²² The certification requirement is one of many tools in the new legislation that furthers Congress’s stated policy goal for CISADA of “imposing an array of tough new economic penalties aimed at persuading Iran to change its conduct.”²³ As previously noted, the FAR was amended on an interim basis to implement CISADA’s new rules, and final acquisition rules are expected to be issued in the near future.

Which Entities Must Certify. Each prospective contractor (i.e., offeror) submitting a bid to the federal government must certify that the offeror or “any person owned or controlled” by the offeror does not conduct any activity for which sanctions may be imposed under the ISA, as amended by CISADA.²⁴ Offerors must make the same certification with respect to contracts for commercial items.²⁵ A “person” under the interim rule is defined as: (1) a natural person; (2) a corporation, business association, partnership, society, trust, financial

institution, insurer, underwriter, guarantor, and any other business organization, any other nongovernmental entity, organization, or group, and any governmental entity operating as a business enterprise; or (3) a successor to any corporation or other business organization.²⁶ The interim rule does not explicitly extend to subcontractors, and thus only facially applies to offerors and persons owned or controlled by offerors. If an offeror is the U.S. subsidiary of a foreign parent company, the rule also does not, by its terms, extend to the foreign parent.

Although the interim rule does not explain when a person is “owned or controlled” by a offeror, the conference report states that “exercising control as a ‘parent company’ over subsidiaries or affiliates should be considered in functional terms, as the ability to exercise certain powers over important matters affecting an entity. ‘Control’ may also be defined according to ownership of a majority or a dominant minority of the total outstanding voting interest in an entity, board representation, proxy voting, a special share, or contractual arrangements, to direct important matters affecting an entity.”²⁷

In addition, CISADA and the interim rule prohibit U.S. government agencies from contracting with any entity—foreign or domestic—that exports certain “sensitive technology” to Iran. The “sensitive technology” includes any hardware, software, or other equipment that restricts the free flow of information in Iran or which monitors, disrupts, or restricts free speech in Iran.²⁸

The interim rule provides for an exception to the certification requirements for offerors seeking to procure “eligible products” under section 308(4) of the Trade Agreements Act of 1974, 19 U.S.C. § 2518(4), of any foreign country or instrumentality designated under Section 301(b) of the Trade Agreements Act of 1974, 19 U.S.C. § 2511(b).²⁹ Offerors are also excluded from the requirement if the solicitation includes a trade agreements certification and the offeror has certified that all the offered products to be supplied are “designated country end products.”³⁰

Remedies and Waiver of the Certification Requirement. If an agency determines that a offeror falsely certified that it or any person it owns or controls does not engage in sanctionable conduct, the agency “shall” take one or more of the following actions: (1) terminate

²⁰ *Id.* § 102(e).

²¹ As noted above, the FAR provisions discussed in this section are the interim regulations issued on September 29, 2010, and may be subject to amendment based on comments received during the rulemaking process. They should be checked at the time of certification or other actions that might be subject to the law.

²² *Id.* § 102(b).

²³ H.R. Rep. No. 111-512 at 43 (2010) (Conf. Rep.). As noted in the Conference Report leading to the bill, the law “requires each prospective contractor submitting a bid to the federal government to certify that the contractor or a person owned or controlled by the contractor does not conduct any activity for which sanctions may be imposed.” *Id.* at 56.

²⁴ 48 C.F.R. § 25.703-2. The interim rule refers to “offerors,” not “contractors.” See *id.* § 25.703-2(a)(1). “Offeror” is not defined in the interim rule, but the FAR defines “offeror” elsewhere as an “offeror or bidder,” which is the legal entity submitting an offer. The conference report states that the interim rule applies to any “prospective contractor” or “person owned or controlled by the contractor.” See H.R. Rep. No. 111-512 at 56.

²⁵ 48 C.F.R. § 52.212-3(o).

²⁶ *Id.* § 25.703-1.

²⁷ H.R. Rep. No. 111-512 at 56.

²⁸ 48 C.F.R. § 25.703-3.

²⁹ *Id.* § 25.703-2(c). Section 308(4) of the Trade Agreements Act of 1974 defines several specific categories of “eligible products” under various free trade agreements. 19 U.S.C. § 2518(4). The foreign countries designated by the Act include parties to NAFTA that will provide “appropriate reciprocal competitive government procurement opportunities to United States products and suppliers of such products”; countries that are not major industrial countries but will provide such opportunities; and least developed countries. 19 U.S.C. § 2511(b).

³⁰ 48 C.F.R. § 52.212-3(o)(2). “Designated country end product” is defined as “a WTO [World Trade Organization] GPA [Agreement on Government Procurement] country end product, an FTA [Free Trade Agreement] country end product, a least developed country end product, or a Caribbean Basin country end product.” *Id.* § 25.003. An “end product” is defined as “those articles, materials, and supplies to be acquired for public use.” *Id.*

the contract; (2) suspend the offeror in accordance with the procedures in FAR subpart 9.4; or (3) debar the offeror from eligibility for federal contracts for a period of not more than 3 years in accordance with the procedures in FAR subpart 9.4.³¹

The available sanctions are similar to the sanctions generally available against government contractors for violations of federal procurement law requirements.³² Under the FAR, government contractors may be debarred or suspended if found liable for any integrity offense; if the contractor committed certain offenses; or if an agency official finds evidence of “any other cause of so serious or compelling a nature that it affects the present responsibility of a contractor.”³³ Debarment or suspension of contractors under the FAR is discretionary.³⁴ Agencies may also use administrative agreements as alternatives to sanctions.³⁵ And, the government may

chose to pursue action against offending contractors under the False Claims Act or other federal statutes.

An agency or offeror can seek a waiver to the certification requirement by submitting a request through the Office of Federal Procurement Policy.³⁶ The waiver request must include a justification with “market research” showing that no other contractor can provide the product or service and explaining why it is in the national interest for the president to waive the certification requirement.³⁷ It must also include documentation regarding the offeror’s “past performance and integrity.”³⁸ The rule specifically references the Federal Awardee Performance Information and Integrity System and other relevant information.³⁹ The request must also disclose the sanctionable activities in which the offeror is engaged, as well as any “relationship or connection” the offeror has with other firms that engage in sanctionable activities.⁴⁰ The president may waive the certification requirement on a “case-by-case basis” if the president certifies that it is in the “national interest,” in writing to the appropriate congressional committees, the Committee on Armed Services of the Senate, and the Committee on Armed Services of the House of Representatives.⁴¹

³¹ *Id.* § 25.703-2(b).

³² Other statutes vary on the details of potential sanctions, including cause of debarment or suspension; whether sanctions are mandatory or discretionary; the duration and scope of the sanctions; and the availability of waiver of sanctions. See generally Kate M. Manuel, Cong. Research Serv., RL 7-5700, Debarment and Suspension of Government Contractors 3 tbl. 1 (2009) (comparing various statutes).

³³ 48 C.F.R. §§ 9.406-2, 9.407-2.

³⁴ See *id.* § 9.402(a).

³⁵ See Office of Management and Budget, *Suspension and Debarment, Administrative Agreements, and Compelling Reason Determinations*, Aug. 31, 2006, available at <http://www.whitehouse.gov/sites/default/files/omb/assets/omb/memoranda/fy2006/m06-26.pdf>.

³⁶ 48 C.F.R. § 25.703-2(d)(2).

³⁷ *Id.* § 25.703-2(d)(3)(v).

³⁸ *Id.* § 25.703-2(d)(3)(vi).

³⁹ *Id.*

⁴⁰ *Id.* § 25.703-2(d)(3)(vii)-(viii).

⁴¹ *Id.* § 25.703-2(d)(1).