

E-ALERT | International Trade -- Foreign Trade Controls

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SENATE PASSES NEW IRAN SANCTIONS LEGISLATION TARGETING NON-U.S. COMPANIES IN PETROLEUM INDUSTRY

House Passed Similar Legislation in December

Separate Export-Import Bank Limitations Targeting Iran also Enacted

On Thursday, January 28, the U.S. Senate passed legislation that would impose new sanctions on non-U.S. companies doing business with Iran, particularly companies that provide refined petroleum products and services to Iran. The Senate legislation must now be reconciled with similar legislation that passed the U.S. House of Representatives in December.

Separately, an appropriations bill enacted into law in December 2009 restricts new Export-Import Bank funding to projects controlled by non-U.S. companies selling refined petroleum products to Iran or facilitating Iran's ability to import or produce domestically refined petroleum products. All of these legislative measures are aimed at pressuring Iran to curtail its nuclear development program, and the Obama Administration is reportedly pursuing additional multilateral sanctions through the United Nations Security Council and in cooperation with key allies.

Background

Existing U.S. law provides for retaliatory measures under the Iran Sanctions Act ("ISA") when an entity organized under the laws of another country makes an "investment" totaling more than US \$20 million in any 12-month period that "directly and significantly contribute[s] to the enhancement of Iran's ability to develop petroleum resources of Iran." (Under the Iranian Transactions Regulations ("ITR," 31 C.F.R Part 560) administered by the U.S. Treasury Department's Office of Foreign Assets Control, legal entities organized under U.S. law are generally prohibited from nearly all business dealings with Iran.) Unless the President exercises certain waiver powers, he is required to impose at least two of the following six specified ISA retaliatory measures on non-U.S. persons engaged in sanctionable "investments": (1) denial of Export-Import Bank financing for exports to the sanctioned person; (2) denial of federal agency licensing, if required, for exports of goods and technology to the sanctioned person; (3) denial of access to U.S. financial institutions for loans or credit in an amount of more than \$10 million in any 12-month period; (4) ineligibility to serve as a primary dealer in U.S. government securities or as an agent of the U.S. government or a repository for U.S. government funds (for financial institutions); (5) ineligibility to contract with the U.S. government as a supplier of goods or services; and (6) restrictions on imports into the United States.

Despite an abundance of raw hydrocarbons, Iran lacks adequate refining capacity and is forced to import vast amounts of refined petroleum products for distribution to its domestic market at subsidized prices. In an effort to apply further economic pressure aimed at convincing the Iranian regime to make concessions related to its nuclear program, the new Senate and House legislation

would, among other measures, amend ISA to broaden the scope of sanctionable activity to target non-U.S. entities that export gasoline and other refined petroleum products to Iran or that otherwise support Iran's capacity to maintain or expand its domestic production of refined petroleum. The legislation also would impose punitive sanctions on such entities, including blocking assets that are subject to U.S. jurisdiction.

Key Provisions of Senate Legislation

The Senate bill, [S. 2799](#), passed by unanimous voice vote, would:

- **Impose sanctions on entities selling refined petroleum products to Iran.** The Senate bill would require the President to impose punitive sanctions on non-U.S. entities that, in more than *de minimis* quantities and "with actual knowledge," sell refined petroleum products to Iran or provide products, technology, services or support that facilitate Iran's ability to import or produce domestically refined petroleum products. (The *de minimis* threshold in the Senate bill is \$200,000 for an individual transaction and \$1 million in the aggregate over a 12-month period.) Activities that would be covered include underwriting or providing insurance for the sale of goods, services, technology or support, financing or brokering such sales, and providing ships or shipping services to deliver refined petroleum products to Iran. The required sanctions include: (1) prohibiting transactions by U.S. parties in foreign exchange with the sanctioned person; (2) prohibiting transfers of credit or payment through a U.S. financial institution if any interest of the sanctioned person is involved; and (3) blocking assets of the sanctioned person that are subject to U.S. jurisdiction.
- **Ban government procurement contracts for ISA-sanctionable entities.** ISA already prohibits U.S. government procurement contracts with ISA-sanctioned entities; the new Senate bill would ban procurement contracts with entities that "meet the criteria" for imposition of ISA sanctions, even if sanctions are not actually imposed. The bill also bans procurement contracts with companies that export communications jamming or monitoring technology to Iran.
- **Expand liability for U.S. companies with subsidiary dealings with Iran.** The Senate bill would sanction a U.S. company if it establishes or maintains a non-U.S. subsidiary to circumvent U.S. sanctions on Iran and the subsidiary engages in conduct that would be prohibited if undertaken within the United States. (Notably, such conduct on the part of a U.S. company would already be prohibited under the Treasury Department's ITR.)
- **Expand the scope of ISA** to cover non-U.S. financial institutions, insurers, underwriters, their parents, subsidiaries, and affiliates, and export credit agencies, if engaged in activity supporting sanctionable investments or the targeted supply of refined petroleum products. (The terms "insurers," "underwriters," "parents," "subsidiaries," and "affiliates" are not further defined in this section of the legislation, though the current version of ISA does define "financial institutions.") The Senate bill also would expand the ISA definition of "petroleum resources" to include "oil or liquefied natural gas tankers" and "products used to construct or maintain pipelines used to transport oil or liquefied natural gas," thus triggering potential ISA sanctions on "investments" in Iran in these areas above the \$20 million threshold, as described above.
- **Codify the asset blocking** imposed by the Treasury Department on certain Iranian officials, their associates, and other Iranian parties who are designated as supporting weapons proliferation, terrorism, other sensitive activities.
- **Authorize U.S. state and local governments to divest** their holdings in entities with investment activities in the energy sector of Iran.
- **Codify and expand the trade embargo.** The Senate bill would block all imports from Iran except informational materials, and restrict exports from the United States to Iran to items such as food,

medicine, medical devices, humanitarian aid, non-sensitive information materials, and certain items supplied under licensing to support the safe operation of U.S.-produced commercial passenger aircraft.

- **Require regular reports** from the President to the Congress regarding companies that are sanctionable under ISA and whether or not sanctions will be applied.
- **Strengthen export controls** by identifying locations where sensitive technology is known to be exported to Iran and, should the location not strengthen its own export controls, impose additional licensing requirements on U.S. exports to such transshipment locations.

Key Provisions of House Legislation

The Senate bill must now be reconciled with the House bill, [H.R. 2194](#), which passed the House on December 15, 2009, by a vote of 412-12. While the bills share many of the same general themes, the House legislation is in some respects less sweeping than the Senate proposal. The key provisions of the House bill include the following:

- **Impose sanctions on non-U.S. entities selling refined petroleum products to Iran**, with provisions that are very similar to the Senate bill but that also include an express ban on U.S. government procurement contracts with such entities.
- **Require the President to make ISA determinations.** The House bill would require the President to immediately initiate an investigation and make a determination whether any non-U.S. companies have engaged in sanctionable activity under ISA (the Senate bill contains no such requirement). The State Department routinely evaluates potential “investments” in Iran’s energy sector that may be sanctionable under ISA but to date has not typically reached a conclusion about whether ISA sanctions have been triggered, thus avoiding the difficult choice of either imposing or waiving sanctions.
- **Expand the scope of ISA**, as under the Senate bill, to cover non-U.S. financial institutions, insurers, underwriters, their parents, affiliates, and subsidiaries, and export credit agencies, if engaged in activity supporting sanctionable “investments” or the targeted supply of refined petroleum products. Like the Senate bill, the House bill also would include tankers and pipelines in the ISA definition of “petroleum resources.”
- **Deny export licenses** for nuclear materials to countries in which a firm found to have aided Iran’s nuclear weapon program is incorporated or headquartered.
- **Extend ISA** until 2016 (five years later than its current expiration date of 2011).

Other key differences between the House and Senate bills include the following:

- The House bill lacks provisions that are present in the Senate bill regarding divestment, liability for U.S. companies with special-purpose subsidiaries dealing with Iran, and codifying the existing trade embargo and asset blocking.
- The Senate bill would require the President to impose sanctions on non-U.S. entities supplying refined petroleum-related products or services *only* when such activities “could directly and significantly” contribute to Iran’s ability to import refined petroleum products; the House bill contains no such limiting language.
- The House bill would allow the President to waive ISA sanctions when “vital to the national security interest”; currently, ISA sanctions can be waived if “important to the national interest.” The Senate bill would permit the President to waive certain of the codified unilateral trade and

economic sanctions against Iran if it is “in the national interest,” but the Senate bill would not alter the waiver standard with respect to ISA.

- The sanctions in the House bill concerning refined petroleum products and related activities would be retroactive to conduct on or after October 28, 2009, when the bill was reported out of the House Committee on Foreign Affairs. The new sanctions in the Senate bill would not be retroactive.

Next Steps and Timing for Senate and House Legislation

The Obama Administration will likely seek amendments to any reconciled House and Senate bill. In the past, the Administration has expressed concern about both the House and Senate versions of the Iran sanctions legislation, particularly those provisions that would place constraints on the President’s flexibility in foreign policy and potentially alienate U.S. allies whose cooperation is important for a multilateral coalition to oppose Iran’s nuclear ambitions. Further, the Administration has expressed concerns about the monetary thresholds, penalty levels, and “blacklisting” in the bills. The Deputy Secretary of State made these specific points both in Congressional testimony in October 2009 and in a letter to Senate Foreign Relations Committee Chairman John Kerry in December 2009. Business groups also have strongly opposed the legislation in current form for similar reasons and because of the potential impact on international business.

The timing on a reconciliation of the two bills is somewhat uncertain, but there is some prospect that the Administration will request that reconciliation be deferred until the Administration has had an opportunity to press for another, stronger Security Council resolution against Iran. Should that effort fail, it may make it easier for the Obama Administration to argue that it had exhausted all multilateral options before imposing new unilateral sanctions.

Assuming the Senate and House pass a reconciled bill, and absent a significant change in the international situation, it seems unlikely that the President would veto legislation tightening sanctions on Iran.

New Restrictions on Ex-Im Bank Financing

The Senate and House bills described above are in addition to new restrictions on financing by the Export-Import Bank of the United States (“Ex-Im Bank”) of projects related to refined petroleum products.

An appropriations bill passed by the House and Senate and signed into law by President Obama in mid-December 2009 prevents the Ex-Im Bank from issuing “any new guarantee, insurance, or extension of credit” for any project that is “controlled by an energy producer or refiner that continues” to (1) “provide Iran with significant refined petroleum resources”; (2) “materially contribute to Iran's capability to import petroleum resources”; or (3) “allow Iran to maintain or expand, in any material respect, its domestic production of refined petroleum resources, including any assistance in refinery construction, modernization, or repair.” The President has authority to exempt private entities from countries deemed to be “closely cooperating” with U.S. efforts related to Iran, or if he determines that such a step is “important to the national security interest of the United States.”

The Congressional conferee notes indicate that, for these purposes, “significant” or “material” means “aggregate transactions undertaken in a 12-month period” valued at over \$20 million, with the State and Treasury Departments to determine which entities meet this standard. The conferee notes also indicate that the Ex-Im Bank is not restricted from modifying existing transactions in light

of the new legislation. However, the conferees “direct the Export-Import Bank to consult with the Committees on Appropriations prior to the modification or extension of financing to any existing project that would otherwise be prohibited by this section.”

Neither the new legislation nor the Congressional conferee notes address the circumstances under which a project will be deemed to be “controlled by” an energy producer or refiner of concern, but there are indications that the Ex-Im Bank is broadly construing this language and related authorities in the information it is soliciting with regard to new projects.

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Covington & Burling LLP has extensive experience with sanctions regimes and has been closely monitoring these and other developments at the federal, state, and international levels related to Iran and other countries. This memorandum is intended to provide only general guidance and not to advise as to the lawfulness of any particular activity. We would be happy to assist our clients as they seek to navigate the intricacies of the legislative and regulatory regimes related to United States foreign trade controls, including those directed at Iran.

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