

E-ALERT | International Trade Controls

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NEW IRAN SANCTIONS IMPOSED BY THE NATIONAL DEFENSE AUTHORIZATION ACT

On December 31, 2011, President Obama signed the National Defense Authorization Act for Fiscal Year 2012 ([H.R. 1540](#)) (“NDAA”), an appropriations bill allocating defense funding for Fiscal Year 2012. Among a wide variety of provisions, the NDAA contains one section – [Section 1245](#) (entitled “Imposition of Sanctions with Respect to the Financial Sector of Iran”) – which directs the President to impose sanctions aimed at limiting Iran’s ability to finance its nuclear ambitions. In particular, Section 1245:

- Designates the financial sector of Iran as a primary money laundering concern, codifying an earlier designation by the U.S. Treasury Department;
- Requires the President to block the property and interests in property of all Iranian financial institutions if such property or interests are or come within the United States or the possession or control of a United States person; and
- Requires the President to impose sanctions on foreign financial institutions that engage in certain transactions with the Central Bank of Iran or an Iranian financial institution identified on the Treasury Department’s List of Specially Designated Nationals and Blocked Persons (“SDN List”).

The legislative history of this statute makes clear that its primary target is financial institutions that do business with the Central Bank of Iran or other designated Iranian financial institutions. Senator Robert Menendez, one of the sponsors, described the legislation on the floor of the Senate as “a serious attempt to sanction the Central Bank of Iran,” and noted that the law would “impose sanctions on those international financial institutions that engage in business activities with the Central Bank of Iran – particularly in the pursuit of petroleum products.” *Congressional Record* (December 1, 2011) at S8105-06. Similarly, Senator John McCain commented that the bill would “curtail Iran’s ability to buy and sell petroleum through its Central Bank, and . . . prevent foreign financial institutions that deal with the Central Bank of Iran from continuing their access to the U.S. financial system.” *Id.* at S8636.

These sanctions could effectively preclude the ability of sanctioned banks to access the U.S. financial market. However, at this early stage, and until the President takes action to implement Section 1245(d), the full scope and impact of the new sanctions remain uncertain. If fully implemented, these sanctions could effectively require non-U.S. financial institutions to cease doing business with the Central Bank of Iran and designated Iranian banks in order to retain access to the U.S. financial system. Even if not fully implemented, the additional measures authorized by the Act may make non-U.S. banks even more wary of processing any transactions involving Iran, or may cause them to decline to do business with Iran altogether. This may make it extremely difficult for non-U.S. companies engaged in transactions involving Iran, even transactions that are not sanctionable under Section 1245 or other U.S. laws, to find banks willing to be involved in such transactions.

OVERVIEW OF THE NEW SANCTIONS

Designation of Iran's Financial Sector as a "Primary Money Laundering Concern"

Under Section 1245(b), Congress designated the financial sector of Iran, including the Central Bank of Iran, as a primary money laundering concern "because of the threat to government and financial institutions resulting from the illicit activities of the Government of Iran, including its pursuit of nuclear weapons, support for international terrorism, and efforts to deceive responsible financial institutions and evade sanctions." As explained in our [November 22, 2011](#) e-alert, the U.S. Treasury Department had already designated Iran as a jurisdiction of primary money laundering concern in accordance with Section 311 of the USA PATRIOT Act. In connection with this designation, the Treasury Department has issued a Notice of Proposed Rulemaking (November 28, 2011, 76 Fed. Reg. 72878) that would require U.S. financial institutions, as a special measure against Iran as a jurisdiction of primary money laundering concern, to apply special due diligence to their correspondent accounts to guard against their improper indirect use by Iranian banking institutions.¹

These designations further isolate Iran's banking sector from the U.S. and global financial system by requiring U.S. financial institutions to obtain additional information about, and retain additional records on, customers in order to make certain that Iranian banking institutions are not involved in any financial transactions involving U.S. banks.

Blocking of Property and Interests in Property of Iranian Financial Institutions

Section 1245(c) of the NDAA blocks and prohibits transactions in all property and interests in property of an Iranian financial institution if such property or interests in property are in the United States, come within the United States, or are or come within the possession or control of a United States person.² Previously, only the property and interests in property of Iranian financial institutions designated on the SDN List were subject to blocking. The new requirement expands the scope of the asset freeze to cover the assets of all Iranian financial institutions. The asset freeze does not take effect until the President acts, likely through an Executive Order, to block such property and interests in property. The President has not yet acted, and the timeframe for any action is unclear.

Sanctions Against Foreign Financial Institutions that Deal with the Central Bank of Iran or SDN-Listed Iranian Banks

Beginning on February 29, 2012, which is 60 days after enactment of the statute, Section 1245(d)(1)(A) of the NDAA requires the President to prohibit or impose restrictions on the ability of a

¹ "Iranian banking institution" is defined under the Notice of Proposed Rulemaking as "any foreign bank chartered by Iran, including any branches, offices, or subsidiaries of such bank operating in any jurisdiction, and any branch or office within Iran of any foreign bank licensed by Iran. In addition, the Central Bank of Iran (Bank Markazi Iran), as well as any foreign bank of which more than 50 percent of the voting stock or analogous interest is owned by two or more foreign banks chartered by Iran, shall be considered an Iranian banking institution. For purposes of this rule, a subsidiary shall mean a company of which more than 50 percent of the voting stock or analogous interest is directly or indirectly owned by another company." See Notice of Proposed Rulemaking, 76 Fed. Reg. 72878.

² A "United States person" is defined under the NDAA as (A) a natural person who is a citizen or resident of the United States or a national of the United States, and (B) an entity that is organized under the laws of the United States or a jurisdiction within the United States. See NDAA § 1245(h).

foreign financial institution to maintain a correspondent or payable-through account³ in the United States if the foreign financial institution has “knowingly conducted or facilitated any significant financial transaction with the Central Bank of Iran or another Iranian financial institution designated by the Secretary of the Treasury for the imposition of sanctions pursuant to the International Emergency Economic Powers Act.” Such designated Iranian financial institutions are listed on the Treasury Department’s [SDN List](#). Section 1245(d)(1)(B) also provides that the President “may” (but is not required to) impose unspecified sanctions with respect to the Central Bank of Iran.

The NDAA does not define what constitutes either “facilitation” or a “significant” financial transaction. In the administration of sanctions regulations more generally, however, the Treasury Department’s Office of Foreign Assets Control (“OFAC”) considers “facilitation” to include virtually any activity, other than clerical activity, that furthers a targeted transaction. OFAC has also defined what constitutes a “significant” transaction with Iran for purposes of Section 104(c) of the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010, which also requires the President to restrict or prohibit the ability of foreign financial institutions to maintain correspondent or payable-through accounts in certain circumstances as a consequence of their dealings with Iran. [Section 561.404](#) of the Iranian Financial Sanctions Regulations ([31 C.F.R. Part 561](#)) provides that whether a transaction is significant will depend on such factors as the size, number and frequency of the transactions performed over a period of time, their nature, the level of awareness of the conduct by the management of the foreign financial institution, the relationship between the foreign financial institution facilitating the transaction and the sanctioned party, the impact of the transaction, and whether deceptive practices were employed to disguise the transaction.

Limitations on the Applicability of the Sanctions Against Foreign Financial Institutions

Despite the broad language of Section 1245(d)(1), other subsections of Section 1245(d) limit the applicability of the required sanctions against foreign financial institutions in significant ways. First, as to foreign financial institutions that are owned or controlled by a foreign government, including a central bank of a foreign country, the sanctions apply only if the institution engages in, or facilitates, a financial transaction for the sale or purchase of petroleum or petroleum products to or from Iran on or after 180 days following the effective date of the statute, which is June 28, 2012. See Section 1245(d)(3).

Second, in order for the sanctions to apply to foreign financial institutions (whether or not they are government-controlled) in connection with transactions they conduct or facilitate for the purchase of petroleum or petroleum products from Iran on or after 180 days following enactment of the Act (*i.e.*, June 28), the President must make a determination that the price and supply of non-Iranian petroleum and petroleum products are sufficient to permit a significant reduction in the purchase of such items from Iran by or through foreign financial institutions. See Section 1245(d)(4). Without such a determination, sanctions will not apply to foreign financial institutions in connection with the purchase of petroleum or petroleum products from Iran. The President is required to make this determination regarding the price and supply of petroleum and petroleum products produced in countries other than Iran not later than 90 days after enactment of the NDAA and every 180 days thereafter. See Section 1245(d)(4)(B). Regardless of whether the President makes such a

³ The term “correspondent account” means an account established to receive deposits from, make payments on behalf of, or handle other financial transactions related to a foreign financial institution. The term “payable-through account” means an account, including a transaction account, opened at a depository institution by a foreign financial institution by means of which the foreign financial institution permits its customers to engage, either directly or through a subaccount, in banking activities usual in connection with the business of banking in the United States. See 31 U.S.C. §§ 5318A(e)(1)(B) and (C).

determination, however, the sanctions remain applicable to foreign financial institutions (other than government-controlled financial institutions) to the extent they engage in significant financial transactions with the Central Bank of Iran or other designated Iranian financial institutions that do not involve the purchase of petroleum or petroleum products from Iran.

Further, sanctions also will not be imposed on foreign financial institutions if the President determines and reports to Congress, not later than 90 days after the President makes the above-noted determination concerning the price and supply of non-Iranian petroleum and petroleum products, that the country with primary jurisdiction over the financial institution has “significantly reduced” its volume of crude oil purchases from Iran during the reporting period. See Section 1245(d)(4)(D). The President must also renew this determination every 180 days.

The President also may waive sanctions for a maximum period of 120 days, renewable for additional 120-day periods, if the President determines that such a waiver is in the national security interest of the United States and if he submits a report to Congress justifying this finding. See Section 1245(d)(5). President Clinton made use of this type of waiver in 1998 to refrain from imposing sanctions against certain foreign oil companies then engaged in developing the South Pars field in Iran.

Finally, Section 1245(d)(2) prohibits the President from imposing sanctions on any person for conducting or facilitating a transaction for the sale of food, medicine, or medical devices to Iran.

Penalties

As with most sanctions regimes administered by the Treasury Department, penalties for violating this statute are set in accordance with Section 205 of the International Emergency Economic Powers Act (“IEEPA”). Under Section 205 of IEEPA, violations of the NDAA may be punished by civil penalties of up to \$250,000 per transaction or twice the value of the transaction, whichever is greater. Criminal penalties can include fines of up to \$1 million and/or jail terms of up to 20 years per violation.

MULTILATERAL DIPLOMACY INITIATIVE

In addition to the sanctions and restrictions outlined above, Section 1245(e) of the NDAA requires the President to carry out multilateral diplomacy to persuade other governments to limit Iran’s use of revenues from Iran’s sales of petroleum and petroleum products to purchase non-luxury goods, and to prohibit the purchase by Iran of military and dual-use items, and any other items that could contribute to Iran’s conventional, nuclear, chemical, or biological weapons programs. The provision further requires the President to conduct outreach to other petroleum-producing countries to encourage them to increase their output of petroleum and petroleum products to counteract the effect of the new sanctions. In signing the NDAA, however, the President issued a so-called “signing statement” asserting, among other things, that this part of Section 1245 “would interfere with my constitutional authority to conduct foreign relations by directing the Executive to take certain positions in negotiations or discussions with foreign governments. [S]hould any application of these provisions conflict with my constitutional authorities, I will treat the provisions as non-binding.” Nonetheless, there is no reason to think that the Administration is opposed to pursuing these kinds of multilateral efforts to further isolate Iran.

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The precise scope of the new U.S. sanctions against Iran is uncertain and may evolve in the near future. We will circulate additional e-alerts concerning these developments as circumstances warrant.

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