

## United States Enacts Sweeping Secondary Boycotts Targeting Iran

July 23, 2010

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## I. INTRODUCTION

On July 1, 2010, President Obama signed into law the [Comprehensive Iran Sanctions, Accountability and Divestment Act of 2010](#) (Public Law 111-195 – “**CISADA**” or the “**Act**”), imposing significant new sanctions on Iran and firms and individuals doing business with Iran. The enactment of CISADA caps months of negotiations among the U.S. House of Representatives, the U.S. Senate, and the Obama administration. Earlier versions of the legislation were approved by Congress in late 2009 and early 2010.<sup>1</sup> The Act goes further than United Nations Security Council (“**UNSC**”) Resolution 1929 targeting Iran, adopted on June 9, 2010, and the Declaration of the European Council on Iran of June 17, 2010, which expresses the Council’s commitment to adopt new measures against Iran.

The sweeping provisions of CISADA have the potential to affect many non-U.S. entities, including financial institutions (banks, investment banks, insurance and reinsurance companies, broker-dealers, mutual funds, and others); petroleum and natural resource companies; exporters of refined petroleum products to Iran; shipping companies; U.S. government contractors; and those with investments in Iran’s energy sector, among others. The aim of the Act is to create a secondary boycott against Iran, restricting access to the U.S. economy to foreign firms that conduct targeted business activities with Iran. CISADA will increase the compliance burden on both U.S. and foreign companies, requiring foreign firms to implement controls to ensure that they limit their exposure to Iran if they wish to continue to do business with the United States. For U.S. firms, particularly financial institutions, more due diligence activities will be required.

The law contains numerous Presidential waiver provisions, but also adds procedural requirements making exercise of certain waiver authority more difficult.

*Many of the provisions of CISADA will not come into force until implementing regulations are issued. It is not known which U.S. government agencies will be responsible for drafting these regulations. The choice of which agency is to issue the regulations may have a significant impact on the obligations imposed and how waiver provisions are exercised. It is also not yet known whether the regulations will be issued as proposed rules with opportunity for public review and comment, or whether the agencies will rely on the foreign affairs exemption from such procedures to issue final or interim final rules. These may be areas in which affected businesses can have an impact by expressing their views on implementation to the Administration.*

## II. EXECUTIVE SUMMARY: HIGHLIGHTS OF CISADA

- **CISADA amends the Iran Sanctions Act (“ISA”) to:**
  - Add new foreign exchange, banking, and asset freezing sanctions that the U.S. President can impose on a foreign firm involved directly or indirectly in Iran’s petroleum development, petroleum refining, or refined petroleum product importation
  - Require the President, subject to certain waiver authority, to impose at least three of nine ISA sanctions on any person engaged in targeted activities
  - Target foreign companies (including insurance, finance and shipping companies) that export to Iran, or assist Iran in producing, refined petroleum products

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<sup>1</sup> CISADA was passed by the Senate unanimously (99-0) and by the House by a vote of 408-8.

- Impose sanctions on U.S. parent companies for their foreign subsidiaries' activities if the parent has actual knowledge or should have known that the subsidiary engaged in ISA-targeted activities
- Impose sanctions on companies that are under common ownership or control with, or are owned by, a sanctioned person if such a company also knowingly engages in the ISA-targeted activities
- Reduce the President's discretion in initiating investigations of ISA-targeted activity or waiving the imposition of ISA sanctions, while adding new time-limited waiver authority with respect to a company from a country closely cooperating with the U.S. on Iran
- Bar, with certain exceptions, the issuance of licenses for nuclear exports to countries with primary jurisdiction over persons found to be assisting Iran to acquire or develop nuclear or advanced conventional weapons or systems for their delivery
- **CISADA imposes new sanctions on third-country financial institutions and mandates Treasury Department regulations that will:**
  - Restrict access to U.S. correspondent and payable-through accounts for third-country banks and other financial institutions found to do business with Iran's Revolutionary Guard Corps, facilitate Iran's weapons of mass destruction ("WMD") program, or facilitate Iran's support for terrorism
  - Require U.S. financial institutions to carry out due diligence with respect to their foreign financial institution clients to ensure that the foreign institutions do not engage in the activities described above
  - Penalize U.S. financial institutions if their foreign subsidiaries engage in the activities described above if a U.S. financial institution *knows or should have known* of the violation by its subsidiary
- **CISADA greatly limits existing U.S. exports to Iran and imports from Iran to the United States**
- **CISADA requires prospective U.S. government contractors to certify that neither they nor persons they own or control are engaged in certain activities relating to Iran**
- **CISADA targets, with travel, financial and trade sanctions, officials of the Government of Iran determined by the President to be responsible for human rights abuses in Iran<sup>2</sup>**
- **CISADA establishes a program to prevent third-country diversion to Iran of U.S.-origin items related to WMD, ballistic missile or advanced conventional weapons capabilities or support for international terrorism, including new export licensing requirements<sup>3</sup>**
- **CISADA permits U.S. state and local governments and public institutions of higher education to adopt measures requiring divestment of public funds and endowment funds**

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<sup>2</sup> These provisions of the Act are not discussed in this memorandum.

<sup>3</sup> These provisions of CISADA are not discussed in detail in this memorandum.

from securities of corporate groups investing in Iran's energy sector, and it provides a safe harbor for Iran investment policy changes by registered investment companies

- CISADA significantly increases penalties for violating statutes authorizing imposition of certain sanctions and export controls

### III. ANALYSIS OF KEY PROVISIONS OF CISADA

#### A. Expanded Sanctions under ISA (Section 102)

##### 1. Adding to Menu of Sanctions

CISADA increases the minimum number of sanctions the President must impose on a person engaged in ISA-targeted activities (a “**sanctioned person**”) from two to three. It adds the following three new sanctions, expanding to nine the menu of mandatory sanctions from which the President can choose:

- prohibiting any foreign exchange transactions subject to U.S. jurisdiction of a sanctioned person,
- prohibiting any banking transactions by U.S. financial institutions involving a sanctioned person, and
- freezing the property and property interests within U.S. jurisdiction of a sanctioned person.

##### *Analysis*

*The President is authorized to issue implementing regulations for these new sanctions, and his choice of federal agency to draft such regulations might significantly affect their scope. The State Department will likely remain responsible for implementation of ISA. However, the Treasury Department's Office of Foreign Assets Control (“**OFAC**”) administers current U.S. blocking sanctions worded very similarly to the text of the asset freeze sanction. If OFAC were delegated implementation responsibility for this sanction and applied its current interpretations, a sanctioned person's majority-owned subsidiaries in the United States would be unable to conduct business – all their accounts and contractual obligations would be blocked. Further, U.S. transactions in, and distributions to U.S. individuals and entities with respect to, the securities of such subsidiaries or the sanctioned person would be prohibited unless licensed.*

##### 2. Petroleum Resources and Refined Petroleum Products

CISADA greatly expands the President's authority to impose sanctions on companies that assist Iran in importing or producing refined petroleum products. It targets (1) investment in the development of Iranian petroleum resources; (2) Iranian production of refined petroleum products; and (3) the exportation to Iran of refined petroleum products by requiring the imposition of sanctions on any person who “**knowingly**”:<sup>4</sup>

- makes an “**investment**” of \$20 million or more (or a combination of investments of \$5 million or more that total at least \$20 million in a 12-month period) that “**directly and significantly contributes**” to the enhancement of Iran's ability to develop “**petroleum resources**”,<sup>5</sup>

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<sup>4</sup> Terms defined in the statute are printed in blue. “Knowingly” means that a person has actual knowledge, or should have known, of certain conduct, circumstances, or a result.

<sup>5</sup> The definition of “**petroleum resources**” is expanded to include petroleum, refined petroleum products, oil or liquefied natural gas, natural gas resources, oil or liquefied natural gas tankers, and products used to construct or maintain pipelines used to transport oil (cont.)

- sells, leases or provides to Iran any goods, services, technology, information or support with a fair market value of \$1 million or more, or an aggregate fair market value of \$5 million during a 12-month period, that could directly and significantly facilitate Iran's domestic production of "refined petroleum products"<sup>6</sup> (including with respect to the construction, modernization or repair of petroleum refineries); or
- sells or provides to Iran refined petroleum products with a fair market value of \$1 million or more or that, during a 12-month period, have an aggregate fair market value of \$5 million or more; or sells, leases or provides to Iran any goods, services, technology, information or support above the same dollar thresholds, that could directly and significantly contribute to Iran's ability to import refined petroleum products.

#### **Financial Institution Implications**

*Underwriting or providing insurance or reinsurance; financing or brokering; and providing ships or shipping services to deliver refined petroleum products to Iran are specifically included as services targeted with respect to refined petroleum product importation. The Act, however, includes an exception for underwriters and insurance providers that the President determines exercise due diligence to avoid underwriting or contracting to provide insurance or reinsurance for the targeted activities.*

### **3. Sanctions on Parents and Affiliates; Other Categories of "Persons"**

CISADA reduces the prior ISA standards for imposition of sanctions on related companies. Sanctions must be imposed on companies for their subsidiaries' activities if the parent had actual knowledge or should have known that the subsidiary engaged in ISA-targeted activities, as well as on companies that are under common ownership or control with, or are owned by, a sanctioned person if such a company also knowingly engaged in the targeted activities.

#### **Financial Institution Implications**

*CISADA also expands the categories of persons against whom sanctions may be imposed under ISA to specifically include the categories "financial institution, insurer, underwriter, [and] guarantor". Such entities were not expressly included in the prior definition of "person", although they were clearly covered by the categories "corporation, business association, partnership," etc.*

### **4. Government Procurement Contracts**

The Act requires persons seeking to enter into procurement contracts with the U.S. Government to certify that they and persons they own or control do not engage in ISA-targeted activities. False certification can result in termination of a contract or debarment. The President may, on a case by case basis, waive the certification requirement if he or she determines that it is in the national interest of the United States to do so. (CISADA also includes a separate government procurement restriction, discussed [here](#).)

### **5. Transfer of Nuclear Technology**

CISADA imposes certain restrictions on any country which has primary jurisdiction over a person subject to ISA sanctions for activities relating to nuclear weapons or related technology, missiles, or certain advanced conventional weapons. It prohibits the transfer to such country of any nuclear

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(cont.)

or liquefied natural gas. The definition of "investment" has been amended to delete the previous exclusion of entry into, performance, or financing of contracts to sell or purchase goods, services or technology.

<sup>6</sup> "Refined petroleum products" means diesel, gasoline, jet fuel (including naphtha-type and kerosene-type jet fuel), and aviation gasoline.

material, facilities, components, or other goods, services, or technology that are or would be subject to a nuclear cooperation agreement between the U.S. and the government of that country. The nuclear export bar will not apply to a country that the President determines does not know or have reason to know about the sanctioned activity or is taking steps to prevent a recurrence of the activity and to penalize the person involved. In addition, the President may approve a transfer on a case by case basis if the President determines that such approval is vital to U.S. national security interests and submits to Congress the justification for the approval.

## **6. New Standards for Presidential Waivers of Imposition of Sanctions**

Prior to its amendment by CISADA, ISA included two separate waiver provisions relating to the imposition of sanctions on persons who engage in targeted conduct. CISADA amends the more general waiver provision contained in Section 9(c) of ISA to tighten the standards for a Presidential waiver with respect to a person engaged in ISA-targeted activities relating to petroleum resources, refined petroleum products, or WMD or other military capabilities.<sup>7</sup> The Act permits a waiver (with no time limit) only if the President determines that it is “necessary” to the national interest of the U.S. to exercise such waiver authority and submits a report to Congress with a specific and detailed rationale for such determination, including an estimate of the significance of a sanctioned action to Iran’s ability to develop petroleum resources, produce or import refined petroleum products, or acquire or develop targeted weapons. The former standard required a determination that the waiver was “important” to the national interest of the United States.

The second pre-CISADA ISA waiver provision, which has been retained in the same form by the Act, authorizes the President to waive sanctions with respect to a “national of a country” engaged in targeted petroleum-related activities for Iran (but not activities related to Iran’s development of WMD or other military capabilities). This waiver provision in Section 4(c)(1)(A) of ISA permits a six-month waiver, which may be renewed for subsequent six-month periods. It requires a certification from the President to Congress that the waiver is “vital to the national security interests of the United States.”

CISADA also adds a new “country-specific waiver” in Section 4(c)(1)(B) which permits the President to waive sanctions under ISA (also only with respect to a person engaged in petroleum-related activities concerning Iran) on a case by case basis, for up to 12 months, with possible six-month renewals. A waiver requires the President to submit a report to Congress identifying the person with respect to which sanctions are being waived and to certify to Congress that the government with primary jurisdiction over the person is closely cooperating with the U.S. in multilateral non-proliferation efforts with respect to Iran (including a description of such efforts) and that the waiver is “vital to the national security interests of the United States.” According to the Joint Explanatory Statement of the Committee of Conference with respect to the Act (the “**Conference Committee Statement**”), Congress intends that the President must initiate an investigation and make a determination with respect to a person before exercising this waiver authority.

### ***Analysis***

*It is unclear how these waiver provisions will be applied. In 1998, the Clinton Administration waived sanctions under ISA (then-named the Iran and Libya Sanctions Act) with respect to the first and only project ever determined to violate the statute, a \$2 billion contract of Total of France and its minority partners, Gazprom of Russia and Petronas of Malaysia, to develop the South Pars gas field in Iran. Secretary of State Albright used the broader waiver authority discussed*

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<sup>7</sup> This waiver is inapplicable to the country-based nuclear export licensing restrictions on the transfer of nuclear materials, facilities, components, and other goods, services or technology, discussed [above](#).

*above (the “necessary to the national security interest” standard). No ISA sanctions have been imposed to date. Some members of Congress have expressed concern that CISADA will be weakened if President Obama exercises his waiver authority under the law. The new law contains several provisions designed to pressure the President not to use blanket waivers, including required reports and certifications to Congress (discussed above) and mandatory investigations (discussed below). Rep. Howard Berman (D.-Calif.), Chairman of the House Foreign Affairs Committee, has said that a waiver will have a “political cost for the White House.”*

## **7. Mandatory Investigations**

The Act amends the investigation provisions of ISA, providing that the President “shall” (formerly “should”) initiate an investigation of a person upon receipt of credible information indicating that such person is engaged in ISA-targeted activities related to petroleum resources or refined petroleum. In addition, the President is now required to make a determination within 180 days of initiating an investigation as to whether the person has engaged in targeted activity and to notify Congress of the basis for any such determination. However, the President need not initiate an investigation, and may terminate an investigation, if he certifies to Congress that the person has stopped or taken significant verifiable action toward stopping the activity and that the President has received reliable assurances that the person will not knowingly engage in such activity in the future. The Conference Committee Statement explains that a company seeking to benefit from this special provision would be expected to continue activity in Iran only pursuant to a contract or other legally binding commitment and to commit to refuse any expansion or extension of business or investment pursuant to a clause in a contract that permits the company to elect to do so. The statement says that binding commitments should be narrowly construed.

The mandatory investigations provisions became effective on July 1, 2010 with respect to investments in petroleum resources in Iran, but will not become effective with respect to activities related to Iran’s production of refined petroleum products or the exportation to Iran of refined petroleum products until at least June 1, 2011, and possibly longer. If the President submits a required report to Congress by June 1, 2011 regarding diplomatic efforts to dissuade persons from engaging in such activities and certifies to a substantial reduction in such activities (which according to the Conference Committee Statement means a roughly 20 to 30 percent reduction) between July 1, 2010 and the date of the report, the effective date of the mandatory investigations provisions will be delayed for a further 180 days. The delay may be extended for additional 180-day periods if the President submits similar reports and certifications about progressive reductions in such activities. Until the “mandatory investigations” provisions become effective, ISA will continue to provide that the President “should” (rather than “shall”) initiate investigations and “should” (rather than “shall”) make a determination regarding a person’s targeted activities.

## **8. Effective Dates**

CISADA’s provisions relating to the effective dates of various sections of the amended ISA are quite complex (as indicated in the discussion of mandatory investigations above), as some provisions contain numerous opportunities for delayed effectiveness (and extensions of such delays) or waivers if certain events occur or certain conditions are met. In addition, for activities previously subject to ISA that commenced before CISADA was enacted, whether the old or new provisions of ISA apply depends on the type of targeted activity that a person is conducting. For example, investments related to the development of Iran’s petroleum resources made prior to enactment that continue are subject to the prior provisions of ISA. Ongoing activities relating to chemical, biological, or nuclear weapons or related technologies are subject to the newly-amended provisions of ISA.

## **9. Sunset**

CISADA delays the expiration of ISA for five additional years, from December 31, 2011 to December 31, 2016.

## B. Codification of New Sanctions Relating to Iran – Imports and Exports (Section 103)

CISADA enacts new trade and financial restrictions against the territory and government of Iran beginning September 29, 2010. The measures adopted in Section 103 are significantly more restrictive than the current provisions of the OFAC-administered Iranian Transactions Regulations (“ITR”). However, the President is granted the authority to issue implementing regulations, including exceptions, to the sanctions imposed in Section 103.<sup>8</sup> The President is also permitted to waive the application of a Section 103 sanctions provision if he or she determines that a waiver is in the U.S. national interest and submits a report to Congress describing the reasons for the waiver. It appears that the numerous interpretations, licenses, and statements of licensing policy contained in the ITR will be overridden by Section 103 unless the President acts to preserve them before September 29, 2010.

### *Analysis*

*The most critical power at risk under CISADA’s tightening of trade sanctions is OFAC’s plenary authority to issue specific licenses to permit necessary or innocuous import or export transactions that simply cannot be foreseen in legislation. The likely injection of Congressional politics into any exercise of the President’s waive-and-report authority renders this authority a poor substitute for flexible authority in OFAC’s licensing regulations.*

#### 1. Import Sanctions

CISADA prohibits the importation into the United States, directly or indirectly, of goods or services of Iranian origin. It preserves the statutory exceptions provided for in Section 203(b) of the International Emergency Economic Powers Act (“IEEPA”), including personal communications, certain in-kind donations, information and informational materials, and travel-related transactions. Notwithstanding the President’s general authority to issue regulations, the authority to issue regulations with an exception permitting the commercial importation of Iranian-origin foodstuffs and carpets (which were allowed to be imported immediately prior to CISADA pursuant to Section 560.534 of the ITR) may only be exercised if the President submits a report to Congress certifying that the exception is in the national interest and describing the reasons for the exception.

*The CISADA import restriction will eliminate many general licenses currently provided in the ITR unless they are reissued or otherwise reauthorized by the President, including licenses for importation of certain Iranian-origin services, importation of gifts, importation of Iranian-origin services related to intellectual property, and the importation of Iranian-origin household and personal effects.*

#### 2. Export Sanctions

CISADA also prohibits the exportation of U.S.-origin goods, services or technology to Iran from the United States or by a U.S. person, wherever located.<sup>9</sup> The Act preserves numerous ITR exceptions, including exports provided for in Section 203(b) of IEEPA; agricultural commodities, medicine, or medical devices,<sup>10</sup> humanitarian assistance; certain services, hardware, software and technology necessary for Internet access or personal Internet communications; goods, services or technology necessary to the safe operation of U.S.-produced commercial aircraft or other commercial aircraft incorporating U.S. parts; and goods, services or technology to support the International Atomic

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<sup>8</sup> It is likely that OFAC will continue administering sanctions against Iran and will be delegated responsibility for these regulations.

<sup>9</sup> The CISADA definition of “U.S. person”, unlike the ITR definition, does not include an individual or entity merely because such person is located in the United States.

<sup>10</sup> These items are permitted to be exported to Iran pursuant to the Trade Sanctions Reform and Export Enhancement Act of 2002; see ITR §560.530.

Energy Agency in Iran or the activities of nongovernmental organizations promoting democracy in Iran.

Export restrictions on particular goods, services or technology shall not apply if the President determines that exportation is in the national interest. The interrelationship of this provision with Presidential waiver authority is unclear from CISADA, and will have to be clarified through regulations.

### ***Analysis***

*As with the new import restrictions, the export restrictions imposed by CISADA will eliminate many significant general licenses currently provided in the ITR, and specific and general licensing authority itself, unless these are reissued or otherwise reauthorized under CISADA by the President by September 29. Among these general licenses are ITR authorizations for the exportation of services by U.S. depository institutions to process certain funds transfers, and by U.S. depository institutions and securities brokers and dealers with respect to “Iranian accounts”. Other ITR-authorized transactions that would not be preserved include the exportation of personal effects, the exportation of legal services, and the exportation of services related to registration and protection of U.S. and Iranian intellectual property.*

### **3. Freezing of Assets**

CISADA requires the blocking of funds and other assets (including certain assets transferred to family members or associates after designation) of Iranian government and military persons<sup>11</sup> who “satisf[y] the criteria for designation with respect to the imposition of sanctions under the authority of [IEEPA]” – a concept that is not defined in CISADA or IEEPA. It is unclear whether the blocking will include persons identified in Appendix A to the ITR as the Government of Iran in addition to Iranian persons whose are designated pursuant to OFAC-administered programs that currently require asset blocking. It would be a very significant tightening of sanctions on Iran if assets of Iranian governmental entities identified in Appendix A were subject to an asset freeze.

#### ***Financial Institution Implications***

*U.S. financial institutions holding assets subject to freezing must report them to OFAC. Section 103 uses the ISA definition of “financial institution”, which includes depository institutions, credit unions, securities firms (including brokers and dealers), insurance companies (including agencies and underwriters), and other companies that provide financial services. The President must report to Congress, identifying those persons whose assets he has decided to freeze.*

### **4. Penalties**

The Act provides that the civil and criminal penalties set forth in IEEPA will apply to persons who violate the import, export and freezing provisions of Section 103 of CISADA or implementing regulations.<sup>12</sup>

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<sup>11</sup> The term “person” seems to mean “individual” in this provision of CISADA.

<sup>12</sup> IEEPA’s maximum civil penalties per violation are the greater of \$250,000 or twice the value of the violative transaction; the maximum criminal penalties are a fine of up to \$1,000,000 and/or, if an individual, up to 20 years’ imprisonment. 50 U.S.C. §1705.

## C. New Economic and Financial Sanctions Not Related to ISA (Section 104)

### 1. U.S. Correspondent and Payable-Through Accounts for Third-Country Financial Institutions: Secondary Boycott on Iran

CISADA requires the Secretary of the Treasury, in consultation with the Secretary of State and any other interested parties whom the Secretary of the Treasury may consider appropriate, by September 29, 2010, to prescribe regulations to prohibit, or impose strict conditions on, the opening or maintaining in the United States of a “correspondent account” or a “payable-through account” for a foreign financial institution that the Secretary finds knowingly:

- facilitates the efforts of the Government of Iran (including Iran’s Revolutionary Guard Corps (“RGC”) or its “agents”<sup>13</sup> or affiliates) to acquire or develop WMD or delivery systems for WMD or to provide support for organizations designated as foreign terrorist organizations or support for acts of international terrorism;
- facilitates the activities of a person subject to financial sanctions pursuant to UNSC resolutions relating to Iran;
- engages in money laundering to carry out an activity described above;
- facilitates efforts by the Central Bank of Iran or any other Iranian financial institution to carry out an activity described above; or
- facilitates a significant transaction or provides significant financial support for:
  - Iran’s RGC or any of its agents or affiliates whose property or interests in property are blocked pursuant to IEEPA; or
  - a financial institution whose property or interests in property are blocked pursuant to IEEPA in connection with Iran’s proliferation of WMD or delivery systems for WMD or Iran’s support for international terrorism.

#### **Financial Institution Implications**

*Implementation of this CISADA secondary boycott provision will require that the Secretary of the Treasury create and maintain a new list of financial institutions found to facilitate, or launder money to support, the above activities. The brief 90-day deadline for issuance of regulations, together with the open-ended consultation provision on regulations could lead the Secretary to issue the regulations as a notice of proposed rulemaking, with an opportunity for public comment, rather than a final rule invoking the President’s foreign affairs exemption from normal comment and review procedures under the Administrative Procedure Act. It is also unknown whether the Secretary will employ a Treasury bank regulatory agency (e.g., the Office of the Comptroller of the Currency) or a Treasury enforcement agency (e.g., the Financial Crimes Enforcement Network or OFAC) to issue the banking regulations. The choice may be important to exercises of waiver authority discussed below.*

#### **(a) Definitions**

CISADA uses several different definitions of “financial institution”. For the sanctions in Section 104 of the Act, the term includes the following categories of financial institutions in the definition used under the Bank Secrecy Act: insured banks, commercial banks and trust companies,

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<sup>13</sup> The term “agent” means an entity established and acting on behalf of a person (here, the RGC) “in order to conceal the identity of the person.”

private bankers, foreign banks' U.S. branches and agencies, credit unions, thrift institutions, SEC-registered brokers and dealers and other brokers and dealers in securities or commodities, investment bankers and investment companies, currency exchanges, insurance companies, and businesses and agencies engaged in an activity determined by the Secretary of the Treasury to be similar to, related to, or a substitute for any activity in which the foregoing regulated U.S. businesses are authorized to engage.<sup>14</sup>

CISADA adopts definitions for the terms “account”, “correspondent account” and “payable-through account” from the USA PATRIOT Act amendments to the Bank Secrecy Act, which defines these terms for banks. The Secretary of the Treasury is authorized to define these terms for non-bank financial institutions covered by Section 104 sanctions,<sup>15</sup> and has to date defined the terms “account” and “correspondent account” for brokers and dealers in securities, futures commission merchants and introducing brokers, and mutual funds.<sup>16</sup> *Therefore, non-bank financial institutions should be attentive to possible regulation under Section 104.* Further, the Secretary of the Treasury is to define what is a “foreign” and what is a “domestic” financial institution, and may further define other terms used in Section 104 of CISADA.

#### **(b) Penalties**

Violations of the mandated regulations on correspondent and payable-through account restrictions will be punishable by the civil and criminal penalties provided for in IEEPA. It is unclear whether exercise of civil penalty and criminal referral authority is subject to the provision requiring consultation with the Secretary of State and permitting such other consultation with other federal agencies and departments and other interested parties as the Secretary of the Treasury considers appropriate.

#### **(c) Treasury Waiver Authority**

The requirement to impose the prohibitions or conditions on correspondent and payable-through accounts described above, or penalties for violation thereof, may be waived by the Secretary of the Treasury if he or she determines that the waiver is “necessary to the national interest of the United States” and submits a report to Congress describing the reasons for the determination.

## **2. Due Diligence on Correspondent and Payable-Through Accounts for Foreign Financial Institutions**

The Secretary of the Treasury, in consultation with the Secretary of State and any other interested parties whom the Secretary of the Treasury may consider appropriate, must prescribe regulations (with no date specified for issuance) requiring U.S. financial institutions (including their foreign branches) maintaining U.S. correspondent accounts or payable-through accounts for foreign financial institutions to do one or more of the following:

- perform an audit of the facilitation and money laundering activities relating to Iran described [above](#) that may be carried out by the foreign financial institution;
- report to the Treasury Department with respect to transactions or other financial services provided with respect to any such activity;

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<sup>14</sup> The “financial institution” definition for Section 104 excludes, among others, money services businesses and credit card system operators as contained in the Bank Secrecy Act definition.

<sup>15</sup> See 31 U.S.C. §5318A(e)(1) & (2).

<sup>16</sup> See 31 C.F.R. §103.175(d).

- certify, to the best of the U.S. financial institution's knowledge, that the foreign financial institution is not knowingly engaged in any such activity; and/or
- establish due diligence policies, procedures and controls reasonably designed to detect whether the Secretary of the Treasury has found the foreign financial institution to knowingly engage in any such activity.

**(a) Penalties**

Violations of these regulations are punishable by civil and criminal penalties contained in the Bank Secrecy Act.<sup>17</sup>

**3. U.S. Financial Institution Liability for Iran-Related Actions of Foreign Subsidiaries**

CISADA also requires the Secretary of the Treasury to prescribe, in consultation with the Secretary of State and any other interested parties whom the Secretary of the Treasury may consider appropriate, by September 29, 2010, regulations prohibiting any person owned or controlled by a U.S. financial institution (referred to herein as a "**foreign subsidiary**") from knowingly engaging in a transaction with or benefitting the RGC or its agents or affiliates whose property or interests in property are blocked pursuant to IEEPA.

**(a) Penalties**

A U.S. financial institution will be subject to IEEPA civil penalties in the event its foreign subsidiary violated the new regulations and the U.S. parent "knew or should have known that the [foreign] person violated, attempted to violate, conspired to violate, or caused a violation of such regulations."<sup>18</sup> The mandate for Treasury Department regulations asserting extraterritorial jurisdiction over foreign persons' actions does not, however, appear to include taking enforcement action against the violating foreign subsidiary.

**(b) Treasury Waiver Authority**

The requirement to impose a penalty on a U.S. parent for a violation by a foreign subsidiary may be waived by the Secretary of the Treasury if he or she determines that the waiver is "necessary to the national interest of the United States" and submits a report to Congress describing the reasons for the determination.

**D. Government Procurement Contracts (Section 106)<sup>19</sup>**

Effective September 29, 2010, the heads of U.S. government executive agencies are prohibited from entering into or renewing a Federal procurement contract with a person that exports sensitive technology to Iran. "**Sensitive technology**" is defined to include hardware, software, telecommunications equipment or other technology that the President determines is to be used to restrict the free flow of information in Iran, or disrupt, monitor or otherwise restrict speech of the people of Iran. The President may waive this prohibition if he or she determines that a waiver is in the national interest and submits a report to Congress describing the reasons for the waiver. Additional flexibility is provided by provisions authorizing the President to exempt specified products and to issue implementing regulations. By July 1, 2011, the

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<sup>17</sup> See 31 U.S.C. §5321(a), which provides for a civil penalty of the greater of the value of the transaction (up to \$100,000) or \$25,000, payable for each day of the continuing violation, and §5322, which provides for a criminal penalties of between \$250,000 and \$500,000 and imprisonment for up to 5 to 10 years, depending on the circumstances.

<sup>18</sup> CISADA, §104(d)(2).

<sup>19</sup> This memorandum does not treat the designation of human rights abusers in Iran, CISADA §105.

Comptroller General of the U.S. must submit to Congress a report assessing the extent to which federal agencies would have entered into or renewed contracts with persons that export sensitive technology to Iran if the Section 106 prohibitions were not in effect.

### **E. Increase in Criminal Penalties for Sanctions and Defense Export Controls Violations (Section 107)**

CISADA harmonizes the penalties for violations of (i) measures taken by the President pursuant to the United Nations Participation Act (authorizing implementation of UNSC-mandated sanctions); (ii) the Arms Export Control Act (authorizing export controls for defense items and prohibiting such exports to state sponsors of terrorism<sup>20</sup>); and (iii) the Trading with the Enemy Act (now authorizing the U.S. Cuba sanctions) to a maximum of \$1 million and/or 20 years' imprisonment.

### **F. State and Local Government Divestment (Title II)**

Title II of CISADA permits state and local governments, including public institutions of higher education, to adopt measures to require the divestment of the government's assets from (or prohibit their investment in) companies (or affiliates of companies) or governmental entities that have an investment of \$20 million or more in the energy sector of Iran (including in a person that provides oil or liquefied natural gas tankers, or products used to construct or maintain pipelines used to transport oil or liquefied natural gas, for the energy sector of Iran), or financial institutions that extend \$20 million or more in credit to another person, for 45 days or more, if that person will use the credit for investment in the energy sector of Iran.

#### ***Financial Institution Implications***

*It is unclear whether CISADA requires that a financial institution know that its borrower intends to use the proceeds of a loan to make an investment in Iran's energy sector in order for the financial institution to be a valid divestment target. The wording of Section 202 ("... if that person **will** use the credit ...") (emphasis added) suggests that some knowledge is required, and therefore a financial institution may be able to defend itself against a claim that its activities come within a state's divestment provisions by conducting due diligence on its borrowers and including in its loan documents standard use of proceeds clauses that prohibit the borrower from using the funds to do business with U.S. sanctions targets.*

Section 203 of CISADA amends the Investment Company Act of 1940 to provide a safe harbor for registered investment companies against civil, criminal or administrative actions for divesting from, or avoiding investing in, securities of companies that have direct investments in Sudan or that engage in investment activities in Iran. The Securities and Exchange Commission is required, within 120 days of enactment, to issue any amendments it finds necessary to the regulations requiring disclosure by divesting companies to include divestments made pursuant to the amendment to the Investment Company Act.

CISADA requires that any divestment measure by a state or local government must provide to each person to which such measure is to be applied 90 days' written notice and an opportunity to respond. The law retroactively approves previously-enacted state and local divestment laws, even if they do not meet certain standards of the new legislation, although the standards relating to 90 days' notice and an opportunity to respond will be required on and after July 1, 2012. This suggests that state and local laws that do not meet the standards of CISADA will have to be amended within the next two years to qualify for

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<sup>20</sup> Currently, Cuba, Iran, Sudan and Syria are designated by the Secretary of State as countries the governments of which have repeatedly provided support for acts of international terrorism.

Congress's effort to waive federal preemption of state, local, or public university foreign policy initiatives under this new law.

## **G. Prevention of Diversion to Iran (Title III)**

Title III of CISADA requires the President to designate countries that allow "substantial diversion" of certain sensitive goods, services or technologies to Iran as "Destinations of Diversion Concern" ("DDC") and requires the imposition of new export licensing restrictions on these countries. The Act gives the President the authority to delay imposing the restrictions if a DDC's government is working to strengthen its export control system and to fight diversion. Title III also requires a Presidential report to Congress by July 1, 2011 on the feasibility of expanding the DDC system beyond Iran to include additional countries. A full discussion of Title III is beyond the scope of this memorandum.

## **H. Mandated Reports (Sections 102(d), 110, 111, and 115)**

CISADA requires the President to submit to Congress a number of reports not described in other sections of this memorandum, including:

- twice-yearly reports on investments in the energy sector of Iran;
- annual reports on the dollar value amount of trade (including in the energy sector) between Iran and each Group of 20 country;
- reports on activities of foreign export credit agencies that are comparable to activities targeted by ISA (plus a requirement to notify Congress prior to approving any co-financing by the Export-Import Bank of the United States in which such a foreign export credit agency will participate); and
- a report on equitable methods for providing compensation on a comprehensive basis to victims of international terrorism who are U.S. citizens, residents or nationals.

## **I. General Provisions (Title IV)**

### **1. Sunset of CISADA (Section 401(a))**

Most of CISADA will terminate and the amendments to the Investment Company Act in the divestment provisions will cease to be effective 30 days after the date the President certifies to Congress that the Government of Iran has ceased providing support for acts of international terrorism and no longer satisfies the designation criteria for a state sponsor of terrorism, and that Iran has ceased its pursuit, acquisition and development of WMD, ballistic missiles and ballistic missile launch technology. The provisions of CISADA that will remain in effect despite the termination are: the amendments to ISA in Section 102; the sanctions on Iranian human rights abusers in Section 105; the increased statutory penalties in Section 107; the technical corrections the Sudan Accountability and Divestment Act of 2007 in Section 205; the increased authorizations for appropriations to fund the Treasury Department's Office of Terrorism and Financial Intelligence and the Commerce Department's Bureau of Industry and Security in Section 109; and the new Commerce Department enforcement authority in Section 305.

## **IV. CONCLUSION**

Much of the impact of CISADA on U.S. and foreign businesses will not be known until implementing regulations are adopted. The President's choice of federal agencies to draft those implementing regulations will significantly affect how the discretion provided to the President by the Act will be approached and exercised. Imposing secondary boycotts against private and government-owned entities from major U.S. trading partners may be counterproductive to U.S. diplomatic efforts to obtain effective

multilateral cooperation against Iran's nuclear and terrorism activities. For that reason, it will not be surprising if the implementation approaches of the Administration are less assertive than those championed in the Conference Committee Statement on CISADA. We will monitor the implementation process and provide updates as regulations and related policy statements are issued that we believe are of interest to Davis Polk clients.

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If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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