

ALERT

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New U.S. Law Targets Foreign Financial Institutions Involved in Significant Financial Transactions With Iran

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On December 31, 2011, President Obama signed into law the National Defense Authorization Act For Fiscal Year 2012 (NDAA or the "Act"). Amended to this major piece of legislation was Section 1245 ("Imposition of Sanctions with Respect to the Financial Sector of Iran"), which requires the president to sanction foreign financial institutions (e.g., foreign banks) that facilitate significant transactions with Iranian banks, particularly with respect to oil transactions. While there are grace periods for compliance, and considerable latitude given to the president to waive imposition of sanctions, the potential ramifications of this legislation are enormous, as they target — for the first time — the export of oil from Iran.

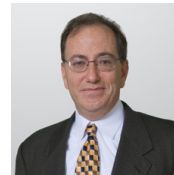
Potential Sanctions Against Foreign Financial Institutions Are Severe

The sanctions match current U.S. rhetoric that foreign entities need to decide to do business either with Iran or the United States. Subject to a 60-day grace period, the president is **required** to prohibit a foreign bank from opening or maintaining correspondent accounts with U.S. financial institutions if the foreign bank knowingly conducts or facilitates significant financial transactions with the Central Bank of Iran or other designated Iranian banks. There is no definition of what constitutes a "significant" financial transaction, and the only exceptions are for transactions involving the sale of food, medicine, or medical devices to Iran. A foreign bank sanctioned under the Act would be largely shut-out of the U.S. banking system, and therefore limited in its ability to conduct any U.S. dollar transactions.

Presidential Discretion and Waivers

Notwithstanding the apparent mandatory nature of these sanctions, the Act gives the Obama administration considerable latitude. For example, Section 1245 of the Act contains several ways in which the administration can prevent imposition against foreign government-owned banks and allies. In particular:

- Foreign government-owned or -controlled banks would have a 180-day grace period and only be subject to this sanction if they engage in transactions related to the sale or purchase of petroleum or petroleum products.



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- With respect to transactions involving the purchase of petroleum or petroleum products from Iran, the above sanction would only apply if the president determines that there is sufficient supply of petroleum and petroleum products to permit a significant reduction in the volumes purchased from Iran – a determination the President must make on a periodic basis.
- Similarly, the sanctions would not apply if the country having jurisdiction over the foreign bank has significantly reduced its volume of crude oil purchases from Iran.
- The president can waive imposition of sanctions for 120-day periods based on a determination that waiver is vital to national security, subject to reporting requirements to Congress.

How Aggressively Will the Sanctions Be Enforced?

The Obama administration has generally sought to limit congressionally-mandated unilateral sanctions, believing that multilateral sanctions are the more effective strategy and that unilateral sanctions hurt international cooperation and limit executive discretion. The president delayed signing the NDAA for 10 days, and ultimately issued a "signing-statement" with "severe reservations" regarding certain provisions dealing with detention, interrogation and prosecution of suspected terrorists. Further, the president indicated that certain sections of the Act, including Section 1245 regarding Iran,

"... 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. ... Should any of these provisions conflict with my constitutional authorities, I will treat the provisions as non-binding."

Notwithstanding the signing statement, it is unlikely that this administration would openly ignore the requirements of the Act and oppose Congress on issues relating to Iran sanctions. It appears that the Obama administration agrees with the goal of this legislation to isolate Iran financially and to cut-off Iran from all oil revenue; however, the administration is very sensitive to the reliance of key allies on Iranian oil and the need for cooperation. Hence, it seems that the administration will take full advantage of the threat of these severe extraterritorial sanctions, and use harsh rhetoric and perhaps select enforcement to forward its policies, while privately giving assurances that banks of key allies will not be sanctioned. Such actions by the administration would be consistent with how it dealt with the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (CISADA), which the administration also sought to limit. U.S. Treasury and State Department officials have used CISADA to make both public and private threats of sanctions, while only imposing sanctions on a relatively small number of foreign entities. Nevertheless, the effect of CISADA on the international shipping community and their insurance carriers has been dramatic.

Freezing of Iranian Bank Assets

The law now requires U.S. persons (e.g., banks) to freeze any property in which an Iranian bank has an interest. While this appears redundant of existing sanctions, in actuality it is not. First, most Iranian banks, even certain banks designated as Specially Designated Nationals (SDNs), are designated under the Iran Transaction Regulations which is a "reject" rather than "blocking" scheme. Only a few banks have been designated under blocking programs such as those for their involvement in facilitating the proliferation of weapons of mass destruction. Further, the Office of Foreign Assets Control (OFAC) will take the position that any involvement of an Iranian bank in a transaction will most likely create an interest, even if the bank's role is *de minimus*, such as providing a letter of credit, acting as an intermediary bank, etc.

Further U.S. Legislation in the Offing

Given the current climate with Iran, it would not be surprising if Congress pushes through additional sanctions against Iran. While the administration may resist behind closed doors, once passed by both the House and Senate, the president would, as a matter of domestic politics, have to sign such legislation into law. In fact, on December 14, 2011, the House overwhelmingly passed two bills, both

of which were referred to the Senate and are currently before the Senate Foreign Relations Committee. One of them, the Iran, North Korea, and Syria Nonproliferation Reform and Modernization Act of 2011 (H.R. 2105), would essentially bar foreign flag vessels from calling on a U.S. port if the vessel has called on Iran, North Korea, or Syria in the previous 180 days. Further, it would require U.S. port officials to look at the ports of call for foreign flag vessels to see if they have called on such embargoed countries, and, if so, to investigate whether there was any sanctionable activity.

Risk Analysis and Advance Planning

Given the rhetoric coming from both Tehran and Washington, D.C., events could move swiftly to a crisis. Therefore, not only do companies need to evaluate their risk under these new sanctions, but any company engaged in substantial business with Iran, if not already winding down business, should have a contingency plan in place to quickly disengage from Iran.

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Jonathan M. Epstein is a partner in the firm's Washington, D.C., office. Mr. Epstein's practice focuses on international trade and transportation law. His trade practice includes advising clients in the maritime, aerospace, electronics, agrochemical, biochemical and other high-technology industries on export, import and related trade issues. His transportation practice focuses on representing clients before the Federal Aviation Administration (FAA) and the Department of Transportation (DOT), and assisting clients in corporate jet transactions and structuring of corporate aircraft operations to comply with FAA regulations.

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