

July 2010 / Special Alert

A legal update from Dechert's Financial Services and Corporate and Securities Groups

Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 Signed Into Law

President Obama signed into law on July 1, 2010 the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (CISADA).¹ CISADA is aimed at thwarting Iran's efforts to obtain nuclear weapons capability and discouraging both U.S. and non-U.S. persons from providing material assistance to Iran's energy sector. Among other things, CISADA amends the Iran Sanctions Act (ISA)² by:

- Directing the President of the United States to impose specified sanctions on persons that support Iran's energy sector, including persons that significantly enhance Iran's ability to develop its petroleum resources or that facilitate the distribution of refined petroleum products to Iran;
- Enabling the Secretary of the Treasury to impose new due diligence and related obligations on U.S. financial institutions—including banks, broker-dealers, investment companies, and insurance companies—that maintain correspondent or payable-through accounts for foreign financial institutions in the United States; and
- Protecting certain parties that divest from, or avoid an investment in, securities issued by persons engaged in certain investment activities in Iran.

¹ Pub. L. No. 111-195, 124 Stat. 1312 (2010).

² Pub. L. No. 104-104, 110 Stat. 56 (1996). The ISA was originally designated as the Iran and Libya Sanctions Act (the "ILSA"). Following termination of sanctions against Libya in 2006, the ILSA was redesignated as the ISA.

U.S. and non-U.S. energy and financial services firms should carefully scrutinize their global operations to ensure that they do not engage in sanctionable activity under CISADA. As discussed below, non-U.S. corporations may face sanctions under CISADA even if they do not have any offices or employees in the United States. Moreover, regulations to be adopted under CISADA will effectively require certain U.S. financial institutions to conduct extensive due diligence on their foreign financial institution counterparties. CISADA also subjects U.S. financial institutions to sanctions if their foreign subsidiaries facilitate dealings with Iran's Revolutionary Guard Corps or any of its agents or affiliates who have been blacklisted by the Treasury Department's Office of Foreign Assets Control. Taken together, these provisions have the potential to represent the most significant extraterritorial expansion of U.S. sanctions against foreign firms since the adoption of the controversial Helms-Burton Act in 1996.³

Expansion of Sanctioned Activity under the Iran Sanctions Act

Background

Originally adopted in 1996, the ISA broadly authorizes the President to impose penalties on any person that the President determines: (i) invests more than \$20 million in the Iranian energy sector; or (ii) exports, transfers, or otherwise provides to Iran any goods or services, knowing that the provision of such

³ Pub. L. 104-114, 110 Stat. 785 (1996) (strengthening sanctions against Cuba, and imposing certain sanctions on non-U.S. companies that engage in dealings in Cuba).

goods or services would contribute materially to Iran's ability to develop or acquire weapons of mass destruction or other military capabilities. Because U.S. persons already are subject to broad sanctions that prohibit dealings in Iran, the ISA is targeted principally at non-U.S. companies that provide material support to Iran. Although the ISA provides the President broad authority to impose these sanctions on persons he deems to be in violation of the ISA, the United States has never pursued sanctions under the ISA, instead preferring to work with other nations to encourage companies to cease activities in Iran voluntarily. As a result, no person has been sanctioned under the ISA to date.

Sanctioned Activity

CISADA strengthens the ISA by broadening the categories of transactions that trigger sanctions under the ISA. Under CISADA, the President must impose sanctions against a person he determines "knowingly:"⁴

- Makes an "investment"⁵ of \$20 million or more (or any combination of investments of at least \$5 million each, which in the aggregate equals or exceeds \$20 million in any 12-month period) that directly and significantly contributes to Iran's ability to develop its petroleum resources;
- Sells, leases, or provides to Iran any goods, services, technology, information, or support with a fair market value of \$1 million or more in a single transaction or \$5 million or more over a 12-month period, if such act could directly and significantly facilitate the maintenance or expansion of Iran's domestic production of refined petroleum products, including any direct and significant assistance with respect to construction, modernization or repair of petroleum refineries; or
- Sells, leases, or provides refined petroleum products to Iran, or provides goods, services, technology, information, or support to Iran, each with a fair market value of \$1 million or more in a single transaction or \$5 million or more over a 12-month period, if such action could directly and significantly contribute to Iran's ability to refine petroleum or import refined petroleum resources,

⁴ The term "knowingly," with respect to conduct, a circumstance or a result, means that a person has actual knowledge or should have known of the conduct, the circumstance or the result.

⁵ The definition of "investment" includes, among other things, financing the sale or purchase of goods, services or technology. Thus, a financial institution that finances the sale of equipment to a petroleum company in Iran may face sanctions under CISADA.

including: (i) underwriting or entering into a contract to provide insurance or reinsurance for the sale, lease, or provision of such goods, services, technology, information, or support;⁶ (ii) financing or brokering such sale, lease, or provision; or (iii) providing ships, vehicles, or other means of transportation to deliver refined petroleum products to Iran).⁷

CISADA also provides for sanctions against the parent, affiliate, and subsidiary of any person determined by the President to be engaged in sanctionable activity, if: (i) in the case of a parent, the parent either had actual knowledge of should have known that its affiliate or subsidiary engaged in sanctionable activities; and (ii) in the case of an affiliate or subsidiary, such entity knowingly engaged in the sanctionable activities.⁸

Sanctions

Under CISADA, the President must impose at least three of nine possible sanctions against persons that are deemed to have engaged in sanctionable activities. Prior to the enactment of CISADA, the ISA authorized the President to:

⁶ CISADA provides a safe harbor for a person that provides underwriting services or insurance or reinsurance, if that person exercises due diligence to ensure it does not provide insurance or reinsurance for the sale, lease, or provision of goods, services, technology, information, or support that could directly and significantly contribute to the enhancement of Iran's ability to import refined petroleum products. Such due diligence would include procedures and controls designed to prevent the support of such activities, and the designation of an official with responsibility for enforcing the policy.

⁷ CISADA also prohibits the issuance of export licenses to a foreign country for peaceful U.S. civil nuclear trade if the country's nationals have engaged in activities with Iran relating to the acquisition or development of nuclear weapons or related technology, or of missiles or other advanced conventional weapons that have been designed or modified to deliver a nuclear weapon. This prohibition may be set aside or waived by the President under various circumstances on a case-by-case basis.

⁸ To determine whether the imposition of sanctions on another person is appropriate, CISADA looks to whether there is ownership or control in the relationship between the persons. "[E]xercising 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, special share or contractual arrangements, to direct important matters affecting an entity." H.R. REP. NO. 111-512, at 56 (2010) (hereinafter referred to as the "Conference Report").

- Deny any guarantee, insurance or extension of credit to the entity from the U.S. Export-Import Bank;
- Deny licenses for the export of military or militarily-useful technology to the entity;
- Deny U.S. bank loans exceeding \$10 million in one year to the entity;
- If the entity is a financial institution, prohibit its service as a primary dealer in U.S. government bonds; and/or prohibit its serving as a repository for U.S. government funds (each counts as one sanction);
- Prohibit U.S. government procurement with the entity; and
- Restrict U.S. imports from the entity.

CISADA amends the ISA to add three new—and more significant—possible sanctions under the ISA. The new sanctions authorize the President to:

- Prohibit any transactions in foreign exchange that are subject to the jurisdiction of the United States and in which a sanctioned person has any interest;
- Prohibit any transfers of credit or payments between, by, through or to, any financial institution, to the extent such transfers or payments are subject to the jurisdiction of the United States and involve any interest of the sanctioned person; and
- Restrict property transactions in which a sanctioned person has any interest.

The Conference Report states that it is the intent of Congress that the President to impose the more significant sanctions against firms that engage in sanctionable activity under the ISA, as amended by CISADA.

Investigations

One of CISADA's most significant changes to the ISA is procedural in nature. Prior to the adoption of CISADA, the ISA stated that the President "should" investigate potential sanctionable activity. CISADA states that the President "shall" investigate a person upon receipt of credible information that such person is engaged in sanctionable activity. Not later than 180 days after an investigation is initiated, the President must make a formal determination as to whether a person has engaged in sanctionable activity. The new provision under CISADA will make it more difficult for the President to ignore potentially sanctionable activity by foreign companies. The Conference Report states that "[b]y not

enforcing current sanctions law, the United States has sent mixed messages to the corporate world when it comes to doing business in Iran by rewarding companies whose commercial interests conflict with American national security goals."⁹

In the case of sanctions for providing Iran with refined petroleum products, or goods or services that could facilitate the maintenance or expansion of Iran's domestic production of refined petroleum products, the mandatory investigations provisions do not go into effect until July 1, 2011. The President may continue to defer mandatory investigations for successive six-month periods if the President certifies that there was a "substantial reduction" in such activities.¹⁰

CISADA also includes a "special rule" designed to provide an incentive for companies that are withdrawing from Iran. It provides that the President need not initiate an investigation, or may terminate an investigation, if the President certifies that the person whose activities are the basis for the investigation is no longer engaging in such activities "or has taken significant verifiable steps toward stopping" such activities, and the President has received reliable, verifiable assurances that the person will not knowingly engage in such activities in the future. The Conference Report states that a company seeking to benefit from this special rule should provide the President with the assurances in writing, in a manner that is transparent and verifiable by the United States government. The Conference Report further states that, to the extent a company benefiting from the special rule is continuing to engage in sanctioned activities, it should be doing so "pursuant solely to a contract or other legally binding commitment," and that "any firm seeking to take advantage of this special rule will commit to refuse any expansion or extension of business or investment pursuant to a clause in a contract that allows a firm to elect to do so."¹¹

Waivers

The President may waive sanctions against a person if the President deems it is "necessary to the national

⁹ *Id.*, at 59.

¹⁰ According to the Conference Report, a "substantial reduction" means "a roughly 20-30% reduction in such activities, a similar reduction in the volume of refined petroleum imported by Iran and/or a similar reduction in the amount of refined petroleum Iran produces domestically." *Id.*, at 60.

¹¹ *Id.*, at 59.

interest of the United States.” Moreover, CISADA allows the President to waive sanctions for up to one year against a person under the jurisdiction of governments that are closely cooperating with the United States in multilateral efforts to prevent Iran from acquiring or developing chemical, biological, or nuclear weapons or related technologies, including ballistic missiles or delivery systems, or acquiring or developing destabilizing numbers and types of conventional weapons. The President must certify that such waiver is vital to the national security interests of the United States, and provide advance notice to Congress of his intent to exercise this waiver. The President may renew a waiver in successive six-month increments.

Reports

CISADA also requires the President, by September 29, 2010 and every 180 days thereafter, to report to Congress on an estimate of the volume of energy-related resources (other than refined petroleum), including ethanol, that Iran imported since January 1, 2006, along with a list of all known energy-related joint ventures, investments, and partnerships located outside of Iran that involve Iranian entities in partnership with entities from other countries. Accordingly, non-U.S. firms that engage in significant energy-related business activities in Iran should anticipate that their activities will be addressed in U.S. government reports in the near future. Even if such firms do not face sanctions under CISADA (e.g., because the President has determined to exercise his waiver authority), it is possible that these reports will be scrutinized by public pension funds and other institutional investors that do not want to invest in entities that do business in Iran.

New Obligations on U.S. and Foreign Financial Institutions

On or before September 29, 2010, the Secretary of the Treasury is required to prescribe regulations prohibiting, or imposing strict conditions on, the opening or maintaining in the United States of a correspondent account or payable-through account¹² by a non-U.S. financial

¹² Under CISADA, the terms “correspondent account” and “payable-through account” have the meanings given those terms in 31 U.S.C. § 5318A. 31 U.S.C. § 5318A(e) broadly defines “correspondent account” to mean “an account established to receive deposits from, make payments on behalf of a foreign financial institution, or handle other financial transactions related to such institution” (emphasis added). The term “payable-through account” means “an account, including a transaction account (as defined in section 19(b)(1)(C) of the Federal Reserve Act), opened at a depository institution by a foreign financial institution by

institution, if the Secretary finds that the non-U.S. financial institution knowingly engages in the following activities (hereinafter “Prohibited Iranian Activities”):

- Facilitation of the Iranian government’s efforts to acquire weapons of mass destruction (“WMD”) or to support international terrorism;
- Dealings with Iranian companies sanctioned by the U.N. Security Council;
- Laundering money to aid Iran’s WMD programs, to support Iran’s sponsorship of terrorism, or to support companies/persons under sanction by the U.N. Security Council;
- Facilitation of efforts by the Central Bank of Iran to aid Iran’s WMD programs, to support Iran’s sponsorship of terrorism, or to support companies sanctioned by the U.N. Security Council; or
- Significant business dealings with Iran’s Revolutionary Guard Corps, its front companies, or its affiliates, or other key Iranian financial institutions currently blacklisted by the Treasury.

The Conference Report states that the Treasury Department is “mandated to pursue relentlessly foreign banks engaged in business with blacklisted Iranian entities,” and that any conditions imposed under this provision should be “stringent and temporary.” However, the Conference Report states that “if foreign financial institutions do not cease their business with blacklisted Iranian entities, after an appropriate warning, the Treasury Department is to direct U.S. banks to sever immediately their correspondent or payable-through account services with these foreign institutions.”¹³ The Treasury Department may waive these sanctions 30 days after the date that the Secretary of the Treasury determines that such a waiver is necessary to the national interest of the United States, and submits to Congress a report describing the reasons for the determination.

CISADA also directs the Treasury Department to issue regulations by September 29, 2010 that require U.S. financial institutions that maintain a correspondent account or payable-through account in the United States for a foreign financial institution, to do one or more of the following:

means of which the foreign financial institution permits its customers to engage, either directly or through a sub-account, in banking activities usual in connection with the business of banking in the United States.”

¹³ Conference Report, at 61.

- Perform an audit to determine whether Prohibited Iranian Activities are being performed by the foreign financial institution;
- Report to the Treasury Department on transactions or other financial services provided by the foreign financial institution with respect to any Prohibited Iranian Activities;
- Certify, to the best of the domestic financial institution's knowledge, that the foreign financial institution is not knowingly engaging in Prohibited Iranian Activities; and
- Establish due diligence policies, procedures and controls reasonably designed to detect whether the Secretary of the Treasury has found the foreign financial institution to be engaging in Prohibited Iranian Activities.

The Treasury Department has authority to define the scope of U.S. financial institutions subject to these requirements, but the statute authorizes the Treasury Department to impose these requirements on U.S. banks, broker-dealers, investment companies, insurance companies, and certain other financial institutions. In addition, CISADA prohibits any person owned or controlled by a domestic financial institution from knowingly engaging in a transaction or transactions "with or benefiting" Iran's Revolutionary Guard Corps or any of its agents or affiliates who have been blacklisted by the Treasury Department. A U.S. financial institution will face sanctions if a person owned or controlled by the financial institution violates, attempts to violate, conspires to violate, or causes a violation of such regulations, and the financial institution knew or should have known that the person violated, attempted to violate, conspired to violate, or caused a violation of such regulations. The Treasury may waive these sanctions 30 days after the date that the Secretary determines that such a waiver is necessary to the national interest of the United States, and submits to Congress a report describing the reasons for the determination.

Protections for Divestment From, or Avoidance of Investment in, Securities Issued by Persons Engaged in Certain Investment Activities in Iran

Creation of a "Safe Harbor" for Changes of Investment Policies by Asset Managers

CISADA amends Section 13(c)(1) of the Investment Company Act of 1940 (the "1940 Act") to provide a "safe harbor" for asset managers that divest from, or avoid

investment in, securities issued by persons that the investment company determines engage in investment activities in Iran described in CISADA.¹⁴ CISADA directs the Securities and Exchange Commission to issue, by October 29, 2010, revisions to regulations requiring disclosure by each registered investment company that divests itself in accordance with Section 13(c) of the 1940 Act.

CISADA also amends Section 13(c)(2)(A) of the 1940 Act to clarify that Congress does not intend with respect to CISADA, and did not intend in the Sudan Accountability and Divestment Act of 2007 ("SADA"),¹⁵ to imply the creation of a new private right of action under Section 13(a) of the 1940 Act. The SADA was enacted in 2007, in part, to empower investment companies to divest assets in companies that conduct business in the Sudan. Last year, a federal judge found a private right of action in Section 13(a) of the 1940 Act, based in large part on the existence of the safe harbor added by the SADA.¹⁶ CISADA undermines this ruling through a "rule of construction" that states "[n]othing . . . shall be construed to create, imply, diminish, change, or affect in any way whether or not a private right of action exists under subsection (a) or any other provision of this Act," and that the amendment "shall apply as if included in the [SADA]." The Conference Report states that "[t]his section is designed to clarify that Congress did not intend, in the [SADA], to imply the creation of a new private right of action under the [1940 Act]."

No Breach of Fiduciary Duty under ERISA

CISADA also expresses the "sense of Congress" that certain divestments, or avoidance of investment, do not constitute a breach of fiduciary duties, obligations, or responsibilities under the Employee Retirement Income

¹⁴ This safe harbor provides that no person may bring any civil, criminal or administrative action against any registered investment company, or any employee, officer, director or investment adviser, thereof, based solely upon the investment company divesting from, or avoiding investment in, securities issued by persons that the investment company determines, using credible information, engage in investment activities in Iran.

¹⁵ Public Law 110-174; 50 U.S.C. 1701 note; see *Sudan Accountability and Divestment Act of 2007 Signed into Law*, *DechertOnPoint*, January 2008, available at http://www.dechert.com/library/FS_1_01-08_Sudan_Accountability_and_Divestment_Act_of_2007.pdf

¹⁶ *Northstar Financial Advisors, Inc. v. Schwab Investments*, 609 F.Supp.2d 938 (N.D. Cal. 2009)

Security Act of 1974 (“ERISA”).¹⁷ Specifically, CISADA states that an ERISA fiduciary may divest plan assets from, or avoid investing plan assets in, any person the fiduciary determines engages in certain investment activities in Iran described in CISADA without breaching the duties imposed on the fiduciary by subparagraphs (A) or (B) of Section 404(a)(1) of ERISA, if: (i) the fiduciary makes such determination using credible information that is available to the public; and (ii) the fiduciary prudently determines that the result of such divestment or avoidance of investment would not be expected to provide the employee benefit plan with either (A) a lower rate of return than alternative investments with commensurate degrees of risk; or (B) a higher degree of risk than alternative investments with commensurate rates of return.¹⁸

Authority of State and Local Governments to Divest

Section 202 of CISADA grants state and local governments the right to adopt and enforce measures to divest governmental funds from firms conducting business operations in Iran’s energy sector and sets standards for them to do so. This provision is intended to validate state and local government measures that require divestment by government plans (including government pension plans) and thus may impact the investment management programs of the plans.

CISADA requires the state or local governments to provide notice to the U.S. Attorney General of the enactment of any such measures, and provide notice and the opportunity to comment to any person from which a state or local government proposes to divest investments in reliance on such measures. Section 202(d)(3) of CISADA provides that a state or local government measure cannot apply to a person who can demonstrate to the governmental authority issuing the notice that the person “does not engage in investment activities in Iran.”

Other Notable Provisions

CISADA 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 engage in any activity for which

sanctions may be imposed under the ISA, as amended by CISADA.

CISADA requires the President to impose sanctions on citizens of Iran that the President determines, based on credible evidence, are complicit in, or responsible for, ordering, controlling or otherwise directing the commission of serious human rights abuses against citizens of Iran or their family members on or after the date of the last Iranian presidential election (June 12, 2009), regardless of whether such abuses occurred in Iran.

CISADA prohibits the federal government from entering into a procurement contract with any entity that the President determines has exported to Iran sensitive communications technology to be used for monitoring, jamming or other disruption of communications by the people of Iran.

Finally, CISADA requires the President, by September 29, 2010, to report to Congress on any activity of a foreign country’s export credit agency that would be comparable to activities for which sanctions may be imposed on a person under CISADA.

Conclusion

CISADA will have a significant impact on the international operations of U.S. and non-U.S. energy and financial services firms. By the end of September 2010, the President will issue his first report on companies that operate in Iran. The findings of this report may trigger the investigations or the initial imposition of sanctions against firms under CISADA. Moreover, U.S. financial institutions should begin preparing to comply with new regulations, expected to be promulgated by the end of September, that will require a reassessment of their dealings with non-U.S. financial institutions that have Iranian ties. In anticipation of these regulations, U.S. financial institutions may wish to begin examining their foreign financial institution counterparties to determine whether they have meaningful ties to Iran—particularly if such ties are with Iran’s Revolutionary Guard Corps. Dechert will continue to monitor the implementation of CISADA and will issue future *DechertOnPoints* as developments warrant.



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¹⁷ Public Law 93-406; 29 U.S.C. 1001 note.

¹⁸ CISADA also makes certain clarifying amendments to SADA to reflect this same divestment standard.

Practice group contacts

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