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International Trade

October 12, 2012

U.S. Companies Now Can Be Liable for Actions of Subsidiaries That Violate Iran Sanctions Rules

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On October 9, 2012 President Obama issued an Executive Order ("E.O.") implementing several provisions of the Iran Threat Reduction and Syria Human Rights Act of 2012 ("Iran Threat Reduction Act"). Most significantly, the E.O. applies to foreign subsidiaries of U.S. persons for the first time most of the sanctions rules that apply to U.S. persons or persons in the United States. Further, the E.O. makes the U.S. parent subject to penalties for violations of the subsidiary. However, such penalties will not apply where the U.S. parent divests or terminates business with the subsidiary by February 6, 2013. It will be important for U.S. companies with non-U.S. subsidiaries to assess whether these affiliates are engaging in prohibited activities vis-à-vis Iran and determine whether U.S. parent needs to take action prior to the divestment date.

The Iran Threat Reduction Act expanded the U.S. Iran sanctions regime via a number of changes and additions to the Iran Sanctions Act of 1996 and The Comprehensive Iran Sanctions, Accountability and Divestment Act of 2010 (July 1, 2010) ("CISADA"). Section 218 of the Act required the President, within 60 days, to address the activities of foreign subsidiaries and provide for liability. The E.O. at Section 4 and new Frequently Asked Questions ("FAQs") published by OFAC on October 9, 2012 address this requirement.

The key questions for U.S. companies are (1) who is a subsidiary; (2) what activity is prohibited; and (3) when may penalties apply?

1. **Who is a subsidiary?** Section 4 of the E.O. applies to entities "owned or controlled by a United States person and established or maintained outside the United States" (a "foreign subsidiary"). Ownership or control is defined in the Iran Threat Reduction Act at § 218 to mean:

    a. To hold more than 50 percent of the equity interest by vote or value in the entity;

    b. To hold a majority of seats on the board of directors of the entity; or

    c. To otherwise control the actions, policies, or personnel decisions of the entity.

While the first two standards are simple metrics, the third standard provides a more flexible and case-specific measure of effective control over "actions, policy, or personnel decisions." U.S. parent companies will need to assess carefully whether their relationship with affiliates and with other companies in which they invest could meet such a standard in the eyes of the U.S. Government at some future date.

2. **What is prohibited for foreign subsidiaries?** Generally, the answer is most activities prohibited for a U.S. person. The E.O. prohibits a Foreign Subsidiary from "knowingly engag[ing] in any transaction, directly or indirectly, with the Government of Iran or any person subject to the jurisdiction of the Government of Iran if that transaction would be prohibited" for a U.S. person under several earlier Executive Orders that implemented a comprehensive ban on transactions, trade in goods and services, and investment involving Iran, Iranian financial institutions, and the Iranian Government, including the Central Bank. The embargo includes the blocking of a number of Iranian parties on the Specially Designated Nationals and Blocked Persons List. Attempts to evade or avoid the E.O. are also prohibited. Foreign subsidiaries are not prohibited from engaging in activities that would be permitted for U.S. companies under an exemption in the Iranian Transactions Regulations or a General License. A foreign subsidiary or its U.S. parent may also apply for a specific license authorizing the subsidiary to engage in otherwise-prohibited activities involving Iran.

3. **What are the penalties for violations by foreign subsidiaries?** Civil penalties assessed for violations by foreign subsidiaries "may" be assessed against the U.S. parent company. Thus, the E.O. appears to leave the U.S. Government some leeway in deciding whether to apply penalties to the U.S. parent or directly to the foreign subsidiary. The civil penalties for each transaction can be up to $250,000 or twice the amount of the transaction. However, penalties for violations by the foreign subsidiary would not apply to the U.S. parent where the U.S. parent "divests or terminates its business with the entity" by February 6, 2013.

U.S. public companies and other issuers should also be aware of new requirements for affiliates. Section 219 of the Iran Threat Reduction Act amended the Securities and Exchange Act to require issuers with annual or quarterly filings to report wherever the issuer or any affiliate knowingly engaged in certain activities prohibited under the Iran sanctions statutes and regulations. Thus, issuers in the United States would be required to report on the activities of their own affiliates or face violations of Securities and Exchange Commission ("SEC") rules. This requirement is effective for reports required by the SEC after February 6, 2013.

The E.O. also addresses several other issues, including blocking of parties who support the Government of Iran in committing human rights abuses (Section 2); blocking of parties who have supported censorship in Iran (Section 3); and providing for penalties to be imposed on persons who improve Iranian petroleum refinement capacities, sell refined petroleum products to Iran, or provide certain enhancements to Iran's ability to import petroleum products where the value of the activity is over specified thresholds (Sections 5-7).

The new rules applied to foreign subsidiaries under the E.O. and to affiliates for SEC reporting make it prudent for companies with international operations to review whether their foreign subsidiaries are engaged in business activities with Iran, even if there is otherwise no U.S. nexus to those transactions.

If you have any questions please contact the Pillsbury attorney with whom you regularly work or the authors:

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