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Recent Developments in U.S. Sanctions Against Iran

July 2, 2018

International Trade Controls

In furtherance of President Trump's May 8, 2018 announcement that the United States is withdrawing from the Joint Comprehensive Plan of Action ("JCPOA") (discussed in our recent alert), on June 27 the U.S. Department of the Treasury's Office of Foreign Assets Control ("OFAC") announced several changes to the U.S. sanctions against Iran. Among other things, OFAC revoked General License H and General License I and amended the Iranian Transactions and Sanctions Regulations ("ITSR") to incorporate two new general licenses authorizing the wind down through November 4, 2018 and August 6, 2018, respectively, of activities previously authorized by those general licenses.

In related developments, recent reports also suggested that the Trump Administration might not be prepared to extend a key sanctions waiver to countries that significantly reduce their oil imports from Iran, but rather might extend such a waiver only to countries that fully eliminate such imports—a development that could be significant for non-U.S. banks in various jurisdictions and companies that purchase or otherwise deal in Iranian oil. However, a U.S. State Department official subsequently clarified that the Administration was focused on working with countries that import Iranian oil on a case-by-case basis "to get as many of them as possible down to zero."

Revocation of Iran General License H

U.S. primary sanctions against Iran prohibit U.S. persons and non-U.S. entities that are owned or controlled by U.S. persons from engaging in virtually any Iran-related dealings without OFAC authorization. As part of the implementation of the JCPOA in January 2016, however, General License H broadly authorized non-U.S. entities that are owned or controlled by U.S. persons to engage in transactions, directly or indirectly, with the Government of Iran or any person subject to the jurisdiction of the Government of Iran that would otherwise be prohibited under the U.S. sanctions, subject to certain conditions. The general license was of broad interest to many non-U.S. subsidiaries of U.S. companies, some of which had started doing business in Iran pursuant to this authorization.

Effective June 27, OFAC revoked General License H, which it had stated in May it would do in connection with the U.S. exit from the JCPOA. OFAC simultaneously issued a general license for wind-down activity that industry had been anticipating since the May announcement. The new general license, set out in ITSR § 560.537, authorizes through November 4, 2018 transactions that are ordinarily incident and necessary to wind down transactions and activities that were previously authorized under General License H.

The new general license recites the activities that had been permitted under the general license, including limited activities by U.S. persons to modify policies and procedures and make certain globally integrated, automated systems available to their non-U.S. affiliates.

In an updated Frequently Asked Question (FAQ 4.4), OFAC indicated that activities by non-U.S. entities owned or controlled by U.S. persons continuing after the conclusion of the wind-down period in violation of the ITSR may be subject to enforcement, and that in considering potential enforcement actions, OFAC will take into account the efforts to wind down any Iran-related activities prior to November 4. Notably, neither the new general license nor the updated FAQ resolves the uncertainty about whether non-U.S. entities owned or controlled by U.S. persons may permissibly collect after November 4 amounts owed for qualified wind-down activities completed by that date.

Revocation of General License I

OFAC also last week revoked General License I. This general license was issued on March 24, 2016 and authorized U.S. persons to engage in transactions ordinarily incident to the negotiation and entry into contracts eligible for authorization under a favorable licensing policy for activities relating to the export or re-export to Iran of commercial passenger aircraft and related parts and services, provided that the performance of any such contract was made contingent on the issuance of a specific license from OFAC.

The underlying Statement of Licensing Policy for Activities Related to the Export or Re-export to Iran of Commercial Passenger Aircraft and Related Parts and Services was issued by OFAC in connection with the JCPOA on January 16, 2016, and, as explained in our recent alert, was revoked as of May 8, when President Trump announced the U.S. withdrawal from the JCPOA.

In its action on June 27, OFAC simultaneously revoked General License I and added to ITSR § 560.536 a general license authorizing through August 6, 2018 the wind down of activities previously authorized by General License I.

Revocation of Other General Licenses

Also last week, OFAC narrowed the scope of other general licenses that previously authorized the importation into the United States of, and dealings in, Iranian-origin carpets and foodstuffs, as well as related letters of credit and brokering services, such that those general licenses now only authorize the wind down of such activities through August 6, 2018.

Under these prior general licenses, U.S. persons were authorized to import certain Iranian-origin goods, including foodstuffs intended for human consumption, carpets and other textile floor coverings, and carpets used as wall hangings. U.S. depository institutions were authorized to issue letters of credit in favor of an Iranian beneficiary in connection with the authorized purchase of such Iranian goods, and U.S. persons wherever located were authorized to act as brokers for the purchase or sale of such authorized Iranian-origin goods.

Until the conclusion of the wind-down period on August 6, 2018, U.S. persons will be authorized to engage in all transactions that are ordinarily incident and necessary to the wind down of transactions that were previously authorized by the relevant general licenses.

Trump Administration's Position on Sanctions Exceptions and Waivers for Reduced Iranian Oil Imports

In addition to these changes made by OFAC, recent reports suggest that the Trump Administration is going to adopt an aggressive position after November 4 with respect to oil imports from Iran by third countries. U.S. law permits an exception to a key financial sanction with respect to banks and other parties in countries that "significantly reduce" the volume of their purchases of oil from Iran. However, one senior State Department official was quoted last week suggesting that because the U.S. goal is to reduce Iranian oil imports to zero, no waivers should be needed from this sanction or will be granted. Subsequent reports suggested that the Administration may be slightly more flexible, noting that it is prepared to work with countries on a case-by-case basis to reduce their oil imports, with the ultimate goal of getting as many countries as possible to fully eliminate their importation of Iranian oil. The Administration's approach to this issue will be critical for financial institutions that operate in countries that currently import Iranian oil and to commercial entities involved in the purchase of Iranian oil.

The issue of granting exceptions from sanctions to countries that significantly reduce their imports of Iranian oil, or sanctions waivers to banks or other parties in those countries, traces back to the U.S. secondary sanctions set out in Section 1245(d) of the National Defense Authorization Act for Fiscal Year 2012 ("FY12 NDAA"). That provision requires the President to prohibit the opening, and prohibit or impose strict conditions on the maintaining, of a correspondent account or a payable-through account in the United States by a non-U.S. financial institution that has knowingly conducted or facilitated any significant financial transaction with the Central Bank of Iran, or any other Iranian financial institution designated under U.S. sanctions. Importantly, Section 1245(d) effectively authorizes the President to waive every 180 days the application of the foregoing sanctions to foreign financial institutions that are subject to the primary jurisdiction of a country that has "significantly reduced" its volume of crude oil purchases from Iran during the prior 180-day period or reduced its crude oil purchases to zero.

The significance of Section 1245(d) extends beyond foreign financial institutions, and reaches commercial entities in some circumstances. For example, prior to its revocation in January 2016, Section 2 of Executive Order 13622 (as amended by Executive Order 13645) authorized the Secretary of State to impose certain retaliatory measures against a person determined to knowingly engage in a significant transaction for the purchase, acquisition, sale, transport, or marketing of petroleum (i.e., crude oil) or petroleum products from Iran unless the person is subject to the primary jurisdiction of a country that has an exception under Section 1245(d) of the FY12 NDAA for significantly reducing or maintaining at zero its volume of crude oil purchases from Iran. It is anticipated that the foregoing sanctions measure will be re-imposed in early November 2018.

During the Obama Administration, exceptions were granted to several countries that cut Iranian oil imports, including Japan, India, South Korea, Turkey, South Africa, Malaysia, Sri Lanka, and ten nations from the European Union. The Obama Administration reportedly treated purchase reductions of approximately 20 percent as "significant."

By contrast, a senior State Department official was quoted stating that the Trump Administration would expect countries to *entirely* eliminate Iranian oil imports so that foreign financial institutions and other parties subject to the primary jurisdiction of those countries would not be sanctioned. However, in subsequent news reports, at least one State Department official signaled greater flexibility, clarifying that the Trump Administration is willing to work with countries on a case-by-case basis to reduce their imports of Iranian oil, with the goal of getting as many countries as possible down to zero imports of Iranian oil.

All indications are, therefore, that the Trump Administration does not intend to set a percentage as its definition of a “significant reduction” for purposes of Section 1245(d). Rather, it will adopt a case-by-case approach, with the goal of getting all countries to the level of zero oil imports from Iran. For countries that are able to reduce to zero immediately (e.g., because they are purchasing Iranian oil on the spot market and can easily purchase from other producers instead), the expectation will be that they do so. For countries that cannot so easily adjust (e.g., because their refineries are specially configured to process Iranian crude), the Administration intends to work with them to reduce their purchases to zero as quickly as is practicable given their circumstances.

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Covington has deep experience advising clients on the legal, policy, and practical dimensions of U.S. trade controls, including the U.S. sanctions against Iran. We will continue to monitor developments in this area, and are well-positioned to assist clients in understanding how this recent announcement may affect their business operations.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our International Trade Controls practice:

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