

# Oil and Fuel Companies Under Increasing Pressure to Stop Iran Business

by Ramsey Jurdi, in Dubai

The US government has ramped up its enforcement of economic sanctions on Iran by levying penalties on non-US companies.

In May, the government imposed penalties on Petróleos de Venezuela (PDVSA), Tanker Pacific Management (Singapore) and two entities within the Samy Ofer shipping organization for engaging in transactions related to refined petroleum with Iran. These companies have been barred from obtaining any significant US bank or Ex-Im bank financing and, in the case of PDVSA, from obtaining US government contracts.

These actions follow a recent flurry of activity by the US State Department to persuade non-US entities to stop doing business with Iran. To a large extent, the State Department has been successful, convincing the likes of LUKOIL, BP, Repsol, Lloyd's of London and Reliance to discontinue business with Iran. Further, Total, Statoil, Eni and Royal Dutch Shell have all formally committed to end their investments in the petroleum sector in Iran, under the threat of penalties by the United States. Sales of refined petroleum to Iran have decreased by 60% in the past year, according to the State Department.

US efforts to curtail business with Iran since the strengthening of sanctions in the summer of 2010 are having a measurable effect. Notably, Iran Air, the national airline, is having difficulty refueling its planes in foreign airports, particularly in Europe. Prague and Budapest were reported in June 2011 to be the only remaining European airports that are willing to refuel Iran Air flights, which has prompted Iranian officials to threaten retaliation by prohibiting refueling of European carriers in Iran.

While US statutes have given the US government authority since 1996 to impose penalties on non-US entities for certain trade with Iran, the government has generally not exercised the authority. However, the US Congress tightened the sanctions in July 2010 through a new statute called the Comprehensive Iran Sanctions, Accountability, and Divestment Act, or CISADA, that expanded the activities subject to penalty, added to the available penalties, and removed much of the discretion previously afforded to the executive branch to impose or not to impose penalties.

## Activities Subject to Penalty

After CISADA, the US government now has authority to penalize non-US companies that engage in three types of activities.

The first is investing in development of the Iranian petroleum industry. The second is selling goods, services or technology to Iran that help Iran produce refined petroleum products. The third is exporting to Iran refined petroleum products or facilitating someone else's exports of refined petroleum products to Iran. Before CISADA, only the first activity was subject to penalty.

The first penalized activity is making an investment that directly and significantly contributes to the enhancement of Iran's ability to develop its petroleum resources. The investment must exceed \$20 million, either by itself or in combination with other investments, in a 12-month period. In March 2011, the US government imposed penalties on Belarusneft, a state-owned Belarusian energy company, based on a 2007 contract valued at \$500 million for development of an oil field in Iran. The increasing risk of penalties appears to have caused Total, Statoil, Eni and Royal Dutch Shell to commit formally to end their investments in the Iranian petroleum industry.

Construction, oil field services and shipping companies are most at risk of violating the ban on selling goods and services that help Iranian refineries. The sanctions target sales of \$1 million or more for a single transaction and multiple transactions exceeding \$5 million in the aggregate during a 12-month period.

The new ban on sales of refined petroleum to Iran is having the most noticeable effect in the petroleum industry because of its applicability to a range of both up-stream and down-stream market participants. The ban applies both to exports of refined petroleum products to Iran and to sales, leases and other provisions of goods, services, technology, information or support to Iran that enhances its ability to import refined petroleum products. An activity must reach \$1 million for a single transaction or \$5 million for multiple transactions in a 12-month period to be covered by the ban. / continued page 2

## Iran Sanctions

*continued from page 1*

Recent penalties and announcements by the US government show the broad reach of this provision.

PDVSA was penalized for exporting reformate, a mid-stream blending component that improves the quality of gasoline, to Iran. The US State Department said the company delivered at least two cargoes of reformate between December 2010 and March 2011 valued at approximately \$50 million.

Tanker Pacific Management was penalized for leasing a tanker to a front company for the Islamic Republic of Iran Shipping Lines (IRISL), and two Samy Ofer group entities were penalized for brokering the same tanker transaction, both considered to be a provision of goods or services that enhances Iran's ability to import refined petroleum products. Interestingly in this case, the US government said the three companies failed to exercise due diligence and did not heed publicly available and easily obtainable information that would have indicated that they were dealing with an IRISL front company.

Swiss energy traders Vitol, Glencore and Trafigura have announced they plan to cease transactions with Iran, and airport fuel companies in many countries are refusing to refuel Iran Air flights.

### Potential Penalties

The US government can choose from a list of nine penalties when penalizing a non-US entity. It must impose at least three of these penalties; only two penalties were required before CISADA was enacted last summer. The penalties can be broadly described as denying the non-US entity the benefits and privileges of doing business with the United States.

The nine possible penalties are 1) denial of assistance from the US Export-Import Bank, 2) denial of export licenses, 3) a bar against US financial institutions lending more than \$10 million in a year to the company, 4) a ban on any financial institution that violates the sanctions from acting as a primary dealer or repository of government funds, 5) debarment from US government contracting, 6) a prohibition on certain foreign exchange transactions, 7) a denial of banking services from US institutions, 8) a freezing of property in the United States and 9) a prohibition on making export sales in the United States.

The penalties against PDVSA for exporting two cargoes of reformate to Iran were a ban on US financial institutions making more than \$10 million in loans to the company, disqualification from US Export-Import Bank assistance and denial of export licenses. These actions are expected to increase

financing costs for PDVSA and prevent it from selling to the US Strategic Petroleum Reserve, which it has done in the past. However, the US government made clear that the penalties will have no effect on PDVSA's ability to export crude oil to the United States and will not apply to PDVSA's US subsidiary, CITGO.

The potential for the US government to target affiliates of an entity transacting business with Iran is a significant risk. CISADA allows the government to penalize the parent company, subsidiaries and sister companies of an entity transacting business with Iran. While the statute requires that the affiliated company have knowledge of the transaction and, in some cases depending on the relationship between the entities, to have participated in it, penalties are hard to fight once imposed and so it is best to assume that affiliated companies will be caught in the same net as the company violating the sanctions.

### Discretion and Diplomatic Efforts

CISADA removed most of the discretion for the government to impose penalties when it finds sanctions violations. Even though the US had the option of penalizing non-US companies doing certain business with Iran since 1996, no penalties had been imposed before September 2010.

One circumstance where penalties can be waived is if the President certifies to Congress that the target company is no longer engaged in the sanctioned activity or is taking verifiable steps toward stopping the sanctioned activity. The President invoked this provision with respect to Total, Statoil, Eni and Royal Dutch Shell.

The US Government is also using diplomacy to head off the need to impose penalties. Diplomatic efforts led jet fuel suppliers in 17 cities in Europe and Asia to stop supplying fuel to Iran Air. Fuel suppliers will be subject to penalties if they sell more than \$1 million in fuel in a single transaction or make multiple sales exceeding \$5 million within a 12-month period. The value of the fuel is assessed based on the fair market value. The government is expected to take an aggressive approach to determining which threshold applies, such as treating a single requirements contract for periodic fueling as a single transaction, subject to the \$1 million threshold instead of the \$5 million threshold.

Sales of fuel to Iran Air are prohibited because Iran Air is an instrumentality of the Government of Iran, a requirement under CISADA. Sales of aviation fuel to private Iranian carriers would not be per se subject to penalty under CISADA. However, the US government is looking / *continued page 3*

## Iran Sanctions

*continued from page 2*

into the possibility of private carriers taking on more fuel than needed in foreign airports and whether the excess fuel is an export subject to penalty.

The US government continues to draw a strong connection between revenue generated from the Iranian energy sector and funding for development of nuclear and missile programs in Iran.

According to the State Department, the drop in sales of refined petroleum is forcing Iran to convert its up-stream petrochemical plants into gasoline refineries, leading to the loss of millions of dollars in export revenue. In view of this, penalties against non-US entities doing business with Iran can be expected to increase. ☺

November 2011