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CRS Report for Congress

The Iran Sanctions Act (ISA)

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Summary

No firms have been sanctioned under the Iran Sanctions Act (ISA). Set to expire in August 2006, bills in the 109th Congress, H.R. 282 (passed by the House on April 26, 2006), S. 333, and H.R. 6198 extended it and added provisions to apply it more strictly. The latter bill, (P.L. 109-293, signed September 30, 2006), extended it until December 31, 2011, changed its name from the Iran-Libya Sanctions Act (ILSA) to ISA by terminating application to Libya, and allows substantial Administration flexibility in applying the new provisions. This report will be updated. See also CRS Report RL32048, *Iran: U.S. Concerns and Policy Responses*, by Kenneth Katzman.

Background and Original Passage of ILSA

ILSA was introduced in the context of a tightening of U.S. sanctions on Iran during the first term of the Clinton Administration. In response to Iran's stepped up nuclear program and its support to terrorist organizations (Hizbollah, Hamas, and Palestine Islamic Jihad), President Clinton issued Executive Order 12957 (March 15, 1995), which banned U.S. investment in Iran's energy sector, and Executive Order 12959 (May 6, 1995), which banned U.S. trade with and investment in that country. The Clinton Administration and many in Congress maintained that these sanctions would deprive Iran of the ability to acquire weapons of mass destruction (WMD) and to fund terrorist groups by hindering its ability to modernize its key petroleum sector. That sector generates about 20% of Iran's GDP. Iran's onshore oil fields, as well as its oil industry infrastructure, were aging and needed substantial investment, and its large natural gas resources (940 trillion cubic feet, exceeded only by those of Russia) were not developed at all at the time ILSA was first considered.

U.S. allies refused to sanction Iran in the mid-1990s, and the Clinton Administration and Congress believed that it might be necessary for the United States to try to deter foreign investment in Iran. The opportunity to do so came in November 1995, when Iran launched its first major effort to open its energy sector to foreign investment, which Iran had banned after the February 1979 Islamic revolution on the grounds that foreign firms would gain undue control over Iran's resources. To accommodate that philosophy while

attracting needed foreign help, Iran developed a "buy-back" investment program under which foreign firms recoup their investments from the proceeds of oil and gas discoveries but do not receive equity stakes.

Some in Congress, with input from the Clinton Administration, developed legislation to sanction such investment. On September 8, 1995, Senator Alfonse D'Amato introduced the Iran Foreign Oil Sanctions Act of 1995 to sanction foreign firms' export to Iran of energy technology. The bill passed the Senate on December 18, 1995 (voice vote) but, in response to criticism that U.S. monitoring of foreign exports to Iran would be too difficult to implement, sanctioned foreign *investment* in Iran's energy sector. On December 20, 1995, the Senate passed still another version that applied all provisions to Libya as well, which at the time was still refusing to yield for trial the two Libyan intelligence agents suspected in the December 21, 1988, bombing of Pan Am 103. The House passed its version of the bill, H.R. 3107, on June 19, 1996 (415-0). The Senate passed a slightly different version on July 16, 1996 (unanimous consent); the House concurred, and the President signed it into law (P.L. 104-172, August 5, 1996).

ILSA was to sunset on August 5, 2001 (5 years after enactment), in the context of somewhat improved U.S. relations with both Iran and Libya. During 1999 and 2000, the Clinton Administration had eased the trade ban on Iran somewhat in response to the more moderate policies of Iran's President Mohammad Khatemi. In 1999, Libya yielded for trial of the Libyan suspects in Pan Am 103. However, proponents of renewal maintained that both countries would view ILSA's expiration as a concession, reducing incentive for further moderation. Renewal legislation (H.R. 1954) was enacted in the 107th Congress (P.L. 107-24, August 3, 2001); it changed the definition of investment to treat any additions to pre-existing investment as a new investment, and required an Administration report on ILSA's effectiveness within 24 to 30 months of enactment. That report was submitted to Congress in January 2004 and did not recommend that ILSA be repealed.

Key Provisions. ILSA requires the President to impose at least two out of a menu of six sanctions on foreign companies (entities, persons) that make an "investment" of more than $20 million in one year in Iran's energy sector.[1] The six sanctions (Section 6) are: (1) denial of Export-Import Bank loans, credits, or credit guarantees for U.S. exports to the sanctioned entity; (2) denial of licenses for the U.S. export of military or militarily-useful technology to the entity; (3) denial of U.S. bank loans exceeding $10 million in one year to the entity; (4) if the entity is a financial institution, a prohibition on its service as a primary dealer in U.S. government bonds; and/or a prohibition on its serving as a repository for U.S. government funds (each counts as one sanction); (5) prohibition on U.S. government procurement from the entity; and (6) restriction on imports from the entity, in accordance with the International Emergency Economic Powers Act (IEEPA, 50 U.S.C. 1701 and following).

The President may waive the sanctions on Iran if the parent country of the violating firm agrees to impose economic sanctions on Iran (Section 4(c)) or if he certifies that doing so is important to the U.S. national interest (Section 9(c)). ILSA terminates for Iran

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[1] For Libya, the threshold was $40 million, and sanctionable activity included exportation to Libya of a broad range of technology of which the export to Libya was banned by Pan Am 103-related Security Council Resolutions 748 (Mar. 31, 1992) and 883 (Nov. 11, 1993).

if Iran ceases its efforts to acquire WMD and is removed from the U.S. list of state sponsors of terrorism. ILSA no longer applies to Libya if the President determines that Libya has fulfilled the requirements of all U.N. resolutions relating to the downing of Pan Am 103. (President Bush made that Libya certification on April 23, 2004.)

Early Reaction. Traditionally skeptical of economic sanctions as a policy tool, European Union states opposed ILSA, at first enactment, as an extraterritorial application of U.S. law. The EU threatened formal counter-action in the World Trade Organization (WTO), and in April 1997, the United States and the EU formally agreed to try to avoid a trade confrontation over it (and a separate "Helms-Burton" Cuba sanctions law, P.L. 104-114). The agreement contributed to a May 18, 1998, decision by the Clinton Administration to waive ILSA sanctions ("national interest" grounds under Section 9(c)) on the first project determined to be in violation: a $2 billion[2] contract, signed in September 1997, for Total SA of France and its minority partners, Gazprom of Russia and Petronas of Malaysia to develop phases 2 and 3 of the 25-phase South Pars gas field. For its part, the EU pledged to increase cooperation with the United States on non-proliferation and counter-terrorism. The Administration indicated that EU firms would likely receive waivers for future projects that were similar. As did its predecessor, the Bush Administration sought to work cooperatively with the EU to curb Iran's nuclear program and limit its support for terrorism rather than risk a rift by imposing sanctions on EU or other firms.

Modifications in the 109th Congress

As the 109th Congress expressed increasing concern about Iran's expanding nuclear program, ILSA was to terminate on August 5, 2006, unless renewed. Some Members were also concerned that its provisions were not being applied to purported violators because of Administration diplomatic considerations. ILSA-related legislation in the 109th Congress included the "Iran Freedom and Support Act," H.R. 282 (Rep. Ros-Lehtinen) and a companion, S. 333 (Sen. Santorum). These bills would not only extend ILSA indefinitely but would also close some perceived ILSA loopholes and authorize funding for pro-democracy activities in Iran. In particular, these bills increased the requirements on the Administration to justify waiving sanctions on companies determined to have violated ILSA provisions; made exports to Iran of WMD-useful technology or "destabilizing numbers and types of" advanced conventional weaponry sanctionable; set a 90-day time limit for the Administration to determine whether an investment constitutes a violation of ILSA (there was no time limit previously); and increased the threshold for terminating ILSA by requiring the Administration to certify, in addition to existing termination requirements, that Iran "poses no threat" to the United States, its interests, and its allies. H.R. 282 also cut U.S. foreign assistance to countries whose companies have violated ILSA's provisions and applied the U.S. trade ban on Iran to foreign subsidiaries of U.S. companies. H.R. 282 was reported out by the House International Committee on March 15, 2006, by a vote of 37-3, with slight amendment. The House passed it on April 26, 397-21. S. 333 had 61 co-sponsors as of June 21, 2006. To prevent ILSA expiration

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[2] Dollar figures for energy investment contracts with Iran represent public estimates of the amounts investing firms are expected to spend during the life of the project, which might in some cases be several decades.

while these bills were being considered, H.R. 5877, extending ILSA until September 29, 2006, was passed by both chambers and signed on August 4, 2006 (P.L. 109-267).

As the 109th Congress was completing its work, a House bill, H.R. 6198, addressed the Administration's concerns that H.R. 282 and S. 333 did not allow sufficient Administration flexibility in their application. H.R. 6198, introduced on September 27, 2006, recommends, but does not require, a 180-day time limit for a determination of violation. It also recommends against U.S. nuclear agreements with countries that have supplied nuclear technology to Iran. It does not apply the trade ban to foreign subsidiaries of U.S. firms, but it does make sanctionable sales of WMD-useful technology or "destabilizing numbers and types of" advanced conventional weaponry. H.R. 6198 also extends ILSA until December 31, 2011, and contains a provision to try to prevent money-laundering by criminal groups, terrorists, or entities involved in proliferating WMD, and it drops Libya from ILSA, as requested by the Administration. H.R. 6198 was passed by the House and Senate by voice vote and unanimous consent, respectively, and President Bush signed it on September 30, 2006 (P.L. 109-293). It formally changes the name of the law to the Iran Sanctions Act (ISA).

Effectiveness and Ongoing Challenges

Some believe ILSA did slow Iran's energy development initially, but, as shown by the projects agreed to below, its deterrent effect weakened as foreign companies began to perceive that actual sanctions would not likely be imposed. Since the 1998 Total SA case, a number of investments in Iran have been formally placed under review for ILSA sanctions by the State Department (Bureau of Economic Affairs). State Department reports to Congress on ILSA, required every six months, state that U.S. diplomats raise U.S. policy concerns about Iran with both investing companies and their parent countries. However, no projects have been determined to be violations or not since then. Still, some energy experts believe that investment would have been much more extensive if not for both ILSA as well as Iran's stringent terms and purported aggressive negotiating style. The new investment has not boosted Iran's sustainable oil production significantly — it is still about 4 million barrels per day (mbd)[3] — and an analysis published by the National Academy of Sciences says that Iranian oil exports are declining to the point where Iran might have negligible exports of oil by 2015.[4] Some questioned the study's conclusions, and others maintain that Iran's gas sector, virtually non-existent in 1998, is becoming an increasingly important factor in Iran's energy future as a result of foreign investment.

Successive Administrations have wrestled with applications of ISA to some kinds of international dealings with Iran. ISA's definition of "investment" does not specifically mention as violations long-term oil or gas purchases from Iran, or the building of energy transit routes to or through Iran. However, the Clinton Administration position was that the construction of energy routes might violate the law, because these routes would "directly and significantly contribut[e] to the enhancement of Iran's ability to develop

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[3] Testimony of Deputy Assistant Secretary of State Anna Borg before the House International Relations Committee, Subcommittee on the Middle East and Central Asia. June 17, 2003.

[4] Stern, Roger. "The Iranian Petroleum Crisis and United States National Security," P*roceedings of the National Academy of Sciences of the United States of America*. Dec. 26, 2006.

petroleum resources."[5] The Clinton Administration used that argument to deter energy routes involving Iran and thereby successfully promote an alternate route from Azerbaijan (Baku) to Turkey (Ceyhan). This route, which became operational in 2005, bypasses both Iran and Russia.

At the same time, the Clinton and Bush Administrations have adopted flexible interpretations of ISA to accommodate the needs of key regional allies for energy supplies. A few weeks after ILSA was first enacted, Turkey and Iran agreed to construct a natural gas pipeline from Iran to Turkey (each country constructing the pipeline on its side of their border). Turkey later announced that, at least initially, it would import gas only from Turkmenistan through this pipeline. In July 1997, the State Department said that the project did not violate the law because Turkey would be importing gas from Turkmenistan, not Iran, and the project would therefore not benefit Iran's energy sector directly. Direct Iranian gas exports to Turkey began in 2001, in apparent contravention of Turkey's pledges not to buy Iranian gas directly, but the Bush Administration has not imposed sanctions on the project.

Further tests of ISA are looming, and some of the large, long-term deals between Iran and Indian, Chinese, and Malaysian firms, listed below, have the potential to significantly enhance Iran's energy export prospects. The value of some of these agreements appears to include long-term contracts to purchase Iranian oil and gas. A related deal, particularly those involving Indian firms,[6] is the construction of a gas pipeline from Iran to India, through Pakistan, with a possible extension to China. All three governments have repeatedly reiterated their commitment to the $4 billion to $7 billion project, which is planned to begin construction in 2007 and to be completed by 2010. Pakistan's President Musharraf said in January 2006 that there is enough demand in Pakistan for Iranian gas to make the project feasible, even if India declines to join it. During her visit to Asia in March 2005, Secretary of State Rice "expressed U.S. concern" about the pipeline deal; other U.S. officials have called the project "unacceptable." No U.S. official has directly stated that it would be considered a violation of ILSA. During his trip to India and Pakistan in March 2006, President Bush said the United States "understand[s]" Pakistan's need for gas, appearing to suggest he would not oppose the pipeline, but Administration officials later said that there was no change in Administration opposition to it. Aside from commercial considerations, the volatility of relations between India and Pakistan could derail the project at any time.

The ISA is not the only mechanism available to the United States to try to limit investment in Iran. The U.S. Treasury and State Departments have begun using U.S. trade regulations to pressure European banks not to do business with Iran, with significant effect on Iran. On December 20, 2005, the Treasury Department had fined Dutch bank ABN Amro $80 million for failing to fully report the processing of financial transactions involving Iran's Bank Melli (and another bank partially owned by Libya). In 2004, the

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[5] This definition of sanctionable activity is contained in Section 5(a) of ILSA.

[6] Some of the Indian companies that reportedly might take part in the pipeline project are ONGC Corp.; GAIL Ltd.; Indian Oil Corp.; and Bharat Petroleum Corp. Some large European companies have also expressed interest. See Solomon, Jay and Neil King. "U.S. Tries to Balance Encouraging India-Pakistan Rapprochement With Isolating Tehran." *Wall Street Journal*, June 24, 2005, p. A4.

Treasury Department fined UBS $100 million for the unauthorized movement of U.S. dollars to Iran and other sanctioned countries, and it and three other European banks, HSBC (Britain), Credit Suisse (Switzerland), and Germany's Commerzbank A.G, have stopped dollar transactions from within Iran or pursuit of new business in Iran. The restrictions on financing are, according to Iranian and outside observers, making it more difficult to fund energy industry and other projects in Iran. On December 20, 2006, Iran's Oil Minister, Kazem Vaziri-Hamaneh, said "Currently, overseas banks and financiers have decreased their co-operation," and Iran would need to tap into a reserve fund to finance some pending projects.

Post-1999 Foreign Investment in Iran Energy Sector

Date	Field	Company(ies)	Value	Output Goal
Feb. 1999	Doroud (oil)	Totalfina Elf/ENI	$1 billion	205,000 bpd
Apr. 1999	Balal (oil)	Totalfina Elf/ Bow Valley (Canada)/ENI	$300 million	40,000 bpd
Nov. 1999	Soroush and Nowruz (oil)	Royal Dutch Shell	$800 million	190,000 bpd
Apr. 2000	Anaran (oil)	Norsk Hydro (Norway)		
July 2000	Phase 4 and 5, South Pars (gas)	ENI	$1.9 billion	2 billion cu.ft./day
Mar. 2001	Caspian Sea oil exploration	GVA Consultants (Sweden)	$225 million	
June 2001	Darkhovin (oil)	ENI	$1 billion	160,000 bpd
May 2002	Masjid-e-Soleyman (oil)	Sheer Energy (Canada)	$80 million	25,000 bpd
Sep. 2002	Phase 9 and 10, South Pars (gas)	LG (South Korea)	$1.6 billion	
Oct. 2002	Phase 6, 7, 8, South Pars (gas)	Statoil (Norway)	$2.65 billion	3 billion cu.ft./day
Feb. 2004	Azadegan (oil)	Inpex (Japan) 10% stake	$200 million Japan stake	260,000 bpd
Oct. 2004	Yadavaran (oil)	Sinopec (China) and ONGC (India)	$70 billion (includes gas purchases for 30 years)	300,000 bpd
June 2006	Gamsar block (oil)	Sinopec (China)	$50 million	unknown
Jan. 2007	Golshan and Ferdows (offshore gas)	SKS Ventures (Malaysia)	$20 billion (includes downstream development and transportation)	100 million cu.ft/day
Totals			**$100 billion+**	**Oil: 1.2 million bpd Gas: 5.1 billion cu.ft/day+**
Pending Deals				
North Pars Gas Field (offshore gas)		China National Offshore Oil Co.	$16 billion	3.6 billion cu.ft/day