

# Iran Sanctions Violations: The Challenge for Washington

May 5, 1997



## Brief Analysis

**T**he April 10 German court finding that Iran's top leaders ordered the assassination of several dissidents in Berlin underscores the hollowness of Europe's policy of engagement with Iran, and presents the U.S. with a unique opportunity to make Iran's leaders pay a real economic price for their brazen disregard of international norms. Unfortunately, recent steps by Washington risk frittering this opportunity away. Most disconcerting was the announcement on April 11—barely 24 hours after the German court ruling—that the U.S. and the European Union (EU) had agreed to pursue avenues for sheltering European companies from the effects of last year's Iran sanctions legislation, the Iran-Libya Sanctions Act (ILSA). Belatedly realizing the agreement's corrosive message, the State Department insisted that the agreement contained "no commitment, legal or political, to grant waivers" from ILSA. But the damage was done. The agreement, coming so close on the heels of the German court ruling, served to fuel growing doubts about America's will to vigorously enforce sanctions.

Those doubts have arisen in large part because of Washington's apparent failure to admonish or sanction the half-dozen companies that have announced deals with Iran. ILSA was enacted in August 1996 to bring pressure on foreign governments by threatening U.S. sanctions against any firm investing significantly in Iran's energy sector. While there is no doubt that the mere passage of ILSA has been a powerful deterrent to companies interested in investing in Iran, the credibility on which that deterrent depends will, over time, be increasingly at risk. To address this problem, the U.S. should make it clear from the highest levels on down that when a violation of ILSA occurs, there will be real consequences. One place to start is by raising a red flag on the half-dozen deals that have already been announced and which may be sanctionable. A public spotlight should be focused on those foreign companies prepared to engage in these transactions.

### Deals in the Offing

**France.** In January, Iran announced that the French company Total bid on the \$850 million second-phase development of Iran's South Pars gas project. There have also been press reports that the Dutch Shell company has reopened talks with Iran on South Pars. While Iran has not yet awarded South Pars to any one company, this project is critical to Iran's development of its entire oil and gas industry because Iran needs the gas from South Pars for re-injection into existing oil fields in order to maintain current oil production levels. Moreover, should Total or another company go through with the South Pars project, other companies will be encouraged to invest in Iran, and U.S. policy toward containing Iran economically will be dealt a severe blow.

**Malaysia.** Two weeks after ILSA was signed into law, it was announced that Malaysia's state-owned Petronas Company agreed to invest \$180 million to develop Iran's Sirri Island fields. Petronas maintains that the deal was actually signed before ILSA took effect. But recent press reports indicate that Petronas is now competing for a second oil field project in Iran, and is interested in other Iranian projects as well. In the wake of the April 10 court ruling in Germany, Iran has also made clear that it intends to pursue vigorously investment from Asia as a counterweight to Europe. The Petronas deal presents the U.S. with an opportunity to use ILSA to impede Iran's

strategy of tapping an important and lucrative investment source in Asia. While Petronas does not have extensive holdings in the U.S. that could be hurt by sanctions, its dealings with American companies in Malaysia could be adversely affected by sanctions .

Turkey. A week after ILSA was enacted, Turkey's state-owned energy company, Botas, signed a \$20 billion natural gas agreement with Iran that includes the construction of a pipeline between the two countries. Turkish officials maintain that the deal constitutes trade (permitted under ILSA as opposed to "investment" which is sanctionable) with Iran and is exempt from ILSA because it was agreed to in May 1995, before the new law went into effect. However, most observers agree that Turkey has violated the spirit, if not the letter, of ILSA by signing this deal with Iran because the deal will help develop Iran's energy sector if it is implemented. The U.S. has sent Turkey mixed signals as to whether Botas will be sanctioned for this deal.

Russia. Since ILSA became law in August 1996, Russian companies and the government have reportedly agreed to three projects with Iran that may be subject to the ILSA sanctions. In November, Russia signed a memorandum with Iran and Turkmenistan to "cooperate in developing hydrocarbons and other mineral resources around the Caspian Sea," according to press reports. In December, Iran and Russia reportedly agreed to form a joint venture for "oil exploration" in the Caspian Sea. In April, the National Iranian Oil Company (NIOC) announced that Iran's Oil Ministry and Russia's Gazprom company signed an agreement on oil and gas "cooperation" where Gazprom will make "direct investments in joint operations in the development of gas fields, production capacity, refining, liquidation and transportation of natural gas." Two Russian oil companies reportedly also formed a consortium and signed an agreement with NIOC for "drilling in Iran's continental shelf." Because the details of these deals have not been made public (particularly how much money, if any, has changed hands), it is difficult to determine if they are covered by ILSA.

Oman. In early January of this year, Oman and Iran reportedly agreed to select firms to develop their shared offshore Hengam gas field in the Strait of Hormuz. According to press reports, senior NIOC officials have said that Oman and Iran have agreed to share the Hengam field on the basis of an 80-20 split in favor of Iran. The field reportedly contains estimated recoverable reserves totaling some 1.15 trillion cubic feet of natural gas and 78 mn barrels of condensate.

Iran Financing Loophole. In addition to the above deals, Germany and Iran have discovered a financing loophole in ILSA, as brought to light in a deal with Germany's state owned Westdeutsche Landesbank which planned to finance the development of Iran's Soroush oilfield project. The project is being undertaken by the Iranian President Hashemi Rafsanjani's son, Mehdi, who heads the Iranian Offshore Engineering and Construction Company. Soroush is one of 11 Iranian "mega-projects" first opened for foreign participation in 1995. Rafsanjani's firm planned to undertake the project itself in a deal variously reported to be worth \$130 million to \$200 million. The German bank agreed to lend \$90 million and to consider an additional package worth \$70 million. While these amounts are clearly over the \$40 million threshold required to trigger ILSA, the catch is that the bank can claim that it is financing investment rather than actually investing. Sanctions against financing were dropped from ILSA before it became law due to concerns from the banking industry about the loss of international business. While this financing deal may not go ahead in the wake of the April 10 German court verdict, it is disturbing that the Germans and Iranians have discovered how to use this financing loophole in ILSA. They reportedly plan to use the German bank deal as a model for escaping the ILSA's penalties in the future.

#### Implications For U.S. Policy

The U.S. needs to seize the opportunity created by Germany's indictment of Iran's leaders to reenergize its own policy. Pressing Europe diplomatically is important but not enough, as shown by the EU's weak response to the German court verdict-basically, withdrawing its ambassadors for a few weeks and suspending ministerial meetings.

It reflects a lowest common denominator style designed precisely to deflect demands for more serious steps. With American credibility on the line, Washington should make it clear at the highest levels that the U.S. intends to enforce ILSA vigorously to deter further investment in Iran and to make Iran's leaders actually pay a real economic price for their sponsorship of international terrorism.

Hillary Mann, an attorney and former aide on the staff of the National Security Council, is an associate fellow of The Washington Institute, focusing on U.S. counter-terrorism policy.

Policy #245

---

## RECOMMENDED

---



BRIEF ANALYSIS

### [Iran Takes Next Steps on Rocket Technology](#)

Feb 11, 2022



Farzin Nadimi

(/policy-analysis/iran-takes-next-steps-rocket-technology)



BRIEF ANALYSIS

### [Saudi Arabia Adjusts Its History, Diminishing the Role of Wahhabism](#)

Feb 11, 2022



Simon Henderson

(/policy-analysis/saudi-arabia-adjusts-its-history-diminishing-role-wahhabism)



## Podcast: Breaking Hezbollah's Golden Rule

Feb 9, 2022



Matthew Levitt

[\(/policy-analysis/podcast-breaking-hezbollahs-golden-rule\)](#)

### TOPICS

[Energy & Economics \(/policy-analysis/energy-economics\)](#)

[Gulf & Energy Policy \(/policy-analysis/gulf-energy-policy\)](#)

[U.S. Policy \(/policy-analysis/us-policy\)](#)

### REGIONS & COUNTRIES

[Iran \(/policy-analysis/iran\)](#)