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Easing of Iran sanctions – an opportunity to (re)enter the market?

The Joint Plan of Action on Iran's nuclear activities, agreed on Sunday, 24 November 2013 between Iran and the E3+3 Group (the US, France, Germany, the UK, China and Russia), attracted worldwide attention. Undoubtedly, the deal has an important political dimension. And it appears to also have legal and economic ramifications. In return for Iran curbing its nuclear program, the E3+3 Group has offered to ease international sanctions on doing business in the country. This newsletter provides an overview of the current sanctions and the extent to which they will be eased over the next few months along with a summary of the practical consequences and advice for companies doing business in Iran or considering doing so in the future.

Background: Current sanctions and recent developments

Iran's diplomatic relations with the international community and with the US in particular have been tense since the Islamic Revolution of 1979.

In 2002, an Iranian dissident group publicly revealed the existence of two nuclear sites under construction: a uranium enrichment facility in Natanz and a heavy water reactor in Arak. Tensions increased after Mahmoud Ahmadinejad became president in 2005 and encouraged the development of Iran's nuclear program. The international community responded by implementing a harsh sanctions regime for business dealings in Iran or with Iranian entities and individuals.

Since 2006, the UN Security Council has adopted six resolutions requiring Iran to stop enriching uranium, some of which also imposed sanctions (cf. UN Security Council Resolutions 1696, 1737, 1747, 1803, 1835 and 1929).

An overview of the current US sanctions regime can be found at http://www.treasury.gov/resource-center/sanctions/Pages/default.aspx.

The European Union has also gradually stepped up the pressure, starting with Regulation (EU) No 423/2007 in 2007, followed in 2010 by Regulation (EU) No 961/2010 and in 2012 by Council Regulation (EU) No 267/2012 (the "**EU Regulations**"). Under the EU Regulations it is currently prohibited, *inter alia*,

- to make funds or any other economic resources available to designated entities or individuals, either directly or indirectly,
- to import or export certain goods from or to Iran, in particular strategic equipment or goods intended for or conducive to Iran's nuclear energy program, including both military and dual-use goods,
- to provide technical assistance – related to certain goods and technologies – to Iranian entities and individuals,
- to transfer more than EUR 10,000 or its equivalent to and from an Iranian individual, entity or other body without prior authorisation or notification (depending on the nature of the goods involved), and
- to participate, knowingly and intentionally, in activities which are intended to circumvent the measures envisaged in the EU Regulations, either directly or indirectly, or which result in such circumvention.

Any violation of the EU Regulations may constitute a criminal offence under the laws of the relevant EU Member State. Under German law, for instance, offences committed by an individual may be subject to a prison sentence of six months to five years or a fine (*Geldbuße*) of up to EUR 1 million. Companies may be fined up to EUR 10 million or more if this is deemed necessary to claw back gains generated by the alleged offences.

With Hassan Rouhani's election as Iranian president in June 2013, Iran seems to have adopted a new approach towards the international community. It resumed negotiations with the E3+3 Group which culminated in the adoption of the Joint Plan of Action on 24 November 2013.

Despite criticism from some quarters, the international media described the Joint Plan of Action as a "breakthrough" in the lengthy negotiation gridlock. According to the preamble of the Joint Plan of Action, the goal for the negotiations between Iran and the E3+3 Group "*is to reach a mutually agreed long-term comprehensive solution that would ensure Iran's nuclear program will be exclusively peaceful*".

Key elements of the Joint Plan of Action

The Joint Plan of Action consists of a "first step" agreement and a non-binding "final step" term sheet.

Under the "first step", Iran accepted, *inter alia*, limits on uranium enrichment and the construction of additional enrichment and (re)processing facilities. It also consented to the monitoring and inspection of its nuclear facilities at Fordow and Natanz by the IAEA and to providing certain information on its plans for nuclear facilities to the IAEA.

In return, the E3+3 Group agreed to ease economic sanctions. This includes a suspension of efforts to further reduce Iran's crude oil sales and releasing oil revenues from frozen accounts, the suspension of US and EU sanctions on petrochemical exports, gold and precious metals, the suspension of US sanctions targeting Iran's auto industry, no further nuclear sanctions from the UN Security Council, the US or the EU, facilitating humanitarian trade for Iran's domestic needs, and increasing the EU authorisation threshold for transactions for non-sanctioned trade to an agreed amount.

The measures agreed under the first step will apply for a period of six months, with the parties entitled to renew them by mutual consent.

The parties hope to implement the final step of what is a very comprehensive solution no more than one year after the adoption of the Joint Plan of Action. This would introduce a long-term arrangement which would, *inter alia*, comprehensively lift UN Security Council, multilateral and national nuclear-related sanctions, involve a mutually defined enrichment program, fully resolve concerns related to the heavy water reactor at Arak, and fully implement transparency measures and enhanced monitoring procedures.

Once the final step has been in place for its full duration, the Iranian nuclear program will be treated in the same way as any non-nuclear weapon state which is a party to the Nuclear Non-Proliferation Treaty.

The parties would be working on the basis with regard to the final and intermediate steps that "nothing is agreed to until everything is agreed to".

Details of changes to Iran sanctions

Under the Joint Plan of Action, the E3+3 Group has offered to ease certain elements of the sanctions regime.

However, this relief, estimated at a total of USD 7 billion, only represents a fraction of the costs that Iran will continue to incur during this first phase under the sanctions that will remain in place. The vast majority of Iran's USD 100 billion in foreign exchange holdings are inaccessible or restricted by sanctions.

Iranian oil exports

In terms of Iranian oil exports, the E3+3 Group has agreed to suspend efforts to further reduce Iran's crude oil sales and to enable Iran's current oil customers to purchase their current average amounts of crude oil.

In addition, the E3+3 Group has promised to enable the repatriation of an agreed amount of revenue held abroad. EU and US sanctions on associated insurance and transport services will be suspended for these oil sales.

According to initial estimates and calculations, this measure could be worth up to USD 4.2 billion, giving it the largest economic impact of all the E3+3 measures to be implemented.

The small number of economies authorised by the US to buy Iranian crude oil (China, India, Turkey, Japan, South Korea and Taiwan) will be allowed to maintain their current buying levels without any need for further reductions. However, the US government does not intend to issue sanction waivers to any other countries to allow them to begin or renew their purchases of Iranian crude oil.

The Joint Plan of Action does not therefore envisage that Iran will increase its aggregate crude oil exports beyond current levels, but will instead facilitate Iran's ability to obtain payment for its existing level of sales in currencies other than USD.

Iranian petrochemical industry

As to Iran's petrochemical exports, the Joint Plan of Action envisages a complete suspension of all US and EU sanctions in this area. This suspension also covers any related services, such as insurance, transportation or financial dealings, subject to the underlying US or EU sanctions applicable, insofar as each service is related to the underlying sanction and required to facilitate the desired transactions. These services could involve any non-designated Iranian entities.

It is reported that an amount of USD 1 billion could be repatriated from petrochemical sales.

Gold and precious metals

A suspension of the ban on Iran's trade in gold and other precious metals is expected to have only a limited economic impact.

The sanctions suspension for this industry sector includes EU and US sanctions and extends to associated services such as insurance, transportation, and financial dealings required to facilitate the desired transactions.

Car industry

Another sector which will enjoy a (temporary) easing of sanctions is the Iranian automotive industry, including any associated services.

This will, however, be more or less limited to US sanctions. This is because the EU have not implemented sanctions specifically targeting the Iranian car industry. The EU sanctions regime prohibits dealings with designated entities or individuals or the export of certain goods. These restrictions remain in place.

Experts estimate that revenues of up to USD 500 million in extra production and sales could be generated by the Iranian car industry due to the lifting of the ban on imports of car parts.

Aviation industry

Iran's aviation industry will not benefit from a comprehensive suspension of sanctions. However, the E3+3 Group agreed to license the supply and installation of spare parts in Iran for Iranian civil aviation flight safety and associated services. The same is true for safety related inspections and repairs.

The Joint Plan of Action expressly states that such sanctions relief even applies to Iran Air, which has been specifically targeted by EU sanctions.

Establishing a financial channel for humanitarian trade

As a general rule, financial sanctions will remain in force for the time being. However, the Joint Plan of Action stipulates an exception in the form of a financial channel to facilitate humanitarian trade for Iran's domestic needs using Iranian oil revenues held abroad. In that sense, humanitarian trade would be defined as transactions involving food and agricultural products, medicine, medical devices, and medical expenses incurred abroad.

This channel will involve specific foreign banks and non-designated Iranian banks which will be defined when establishing the channel. This channel would also be used for transactions required to pay Iran's UN obligations, as well as direct tuition payments to universities and colleges for Iranians studying abroad.

Increase in the EU authorisation threshold

It is also the plan for the EU to increase its authorisation thresholds for financial transactions for humanitarian and non-sanctioned trade with Iran.

The Council of Ministers of the EU will be asked to adopt legislation to amend these sanctions and the new provisions would then apply to all EU member states.

Moratorium on new nuclear-related sanctions

Finally, the E3+3 Group will ensure that neither the EU nor the UN Security Council will impose any new nuclear sanctions for the next six months.

The US administration, acting consistently with the respective roles of the president and Congress, will also refrain from imposing new nuclear sanctions.

It is worth noting that this moratorium only applies to nuclear sanctions. The Joint Plan of Action does not provide for any obstacles to the implementation of new sanctions in response to Iran’s support of international terrorism.

Practical consequences

According to the media, the first amendments to the EU Regulations reflecting the agreed measures under the Joint Plan of Action are expected to be announced in December 2013 or January 2014.

Although insurance companies, the transport industry and car part and aircraft part manufacturers appear to be the main winners of the Iran deal from a business perspective, the temporary relief from sanctions is structured so that the overwhelming majority of the sanctions regime remains in place.

This means that any companies doing business in Iran, or considering doing so, will not substantially benefit from the agreed first step of the Joint Plan of Action. If those companies are currently prevented from engaging in business activities in Iran due to sanctions, they will generally still be prevented from doing so under the Joint Plan of Action.

The main issue, however, will be whether or not Iran complies with the measures it committed to under the Joint Plan of Action. According to the White House fact sheet, "*during the six-month initial phase, the E3+3 Group will negotiate the contours of a comprehensive solution. Thus far, the outline of the general parameters of the comprehensive solution envisions concrete steps to give the international community confidence that Iran's nuclear activities will be exclusively peaceful. With respect to this comprehensive resolution: **nothing is agreed** to with respect to a comprehensive solution **until everything is agreed** to. Over the next six months, we will determine whether there is a solution that gives us sufficient confidence that the Iranian program is peaceful. If Iran cannot address our concerns, we are prepared to increase sanctions and pressure.*"

Advice for corporations

As the White House stated, this first step has achieved a great deal in its own right. While the Joint Plan of Action undoubtedly marks a historical milestone in the negotiations on Iran's nuclear program, it leaves the comprehensive international sanctions regime untouched. The Joint Plan of Action seems to be of greater importance from a political perspective than from a legal and economic one.

In view of the (only) temporary easing of some of the secondary sanctions as agreed under the Joint Plan of Action and while a comprehensive solution which could result in a substantial easing of international sanctions being subject to the successful implementation of the final step (as outlined above), "wait and see" appears to be the most advisable approach for companies contemplating doing business in Iran.

Uncertainty about Iran's full compliance with its undertakings under the Joint Plan of Action and the outcome of future negotiations will continue for the time being. This means that anyone seeking new opportunities to do business in Iran will still encounter significant risks.

Authors




Stefan Gentzsch, LL.M.
Senior Associate

T: +49 69 7199 1492
E: stefan.gentzsch
@cliffordchance.com

Dr. Alexander Cappel
Senior Associate

T: +49 69 7199 1458
E: alexander.cappel
@cliffordchance.com

Dr. Paul Hauser, LL.M.
Associate

T: +49 69 7199 1410
E: paul.hauser
@cliffordchance.com

Dr. Alexander Weiss
Associate

T: +49 89 21632 8713
E: alexander.weiss
@cliffordchance.com

Notes

Clifford Chance, Mainzer Landstraße 46, 60325 Frankfurt am Main, Germany

Clifford Chance Partnerschaftsgesellschaft von Rechtsanwälten, Wirtschaftsprüfern, Steuerberatern und Solicitors ·

Sitz: Frankfurt am Main · AG Frankfurt am Main PR 1000

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