

December 5, 2013

Opportunities and Pitfalls of Proposed Easing of Iran Sanctions

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After years of fitful progress and failure, Iran and the five permanent members of the United Nations Security Council (China, France, Russia, the United Kingdom, and the United States) and Germany (collectively the “P5+1”) reached a tentative, incremental, and interim deal on November 23, 2013. The Joint Plan of Action (the “JPA”) proposes contingent economic relief measures to Iran, provided Iran takes measurable and verifiable steps to limit its nuclear program. Although the JPA itself does not modify any of the existing sanctions laws and regulations nor authorize any specific transactions or trade with Iran, below we provide some practical analysis for persons (US and non-US) contemplating doing business with Iran in the near future.

What You Need to Know

- The proposed changes to the international sanctions regimes (both US and EU) are not presently in effect. All current US sanctions will continue to apply until Iran takes measureable steps that are verified by the International Atomic Energy Agency (“IAEA”). The JPA is contingent upon Iran fulfilling its obligations, *i.e.*, the prerequisites of any lifting of economic sanctions targeting Iran must be fulfilled, and *no sanctions will be suspended until Iran complies with its obligations.*
- Even after such measures have been verified, we believe most sanctions relief will *not* apply to US persons and will only apply to secondary sanctions (US sanctions relating to non-US persons) with few exceptions, *i.e.*, from a US perspective, these temporary measures will not impact the status quo.

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- While the US may relax certain sanctions for non-US persons, non-US persons will still be subject to their respective countries' sanctions laws, or the sanctions laws of the EU, if applicable, which may be more or less limiting in their restrictions. We believe, however, that EU sanctions will largely parallel the easing of US sanctions.
- US sanctions relief measures will be temporary and immediately reversible.
- Any Iranian US sanctions not directly addressed by the JPA will remain in full effect and be *vigorously enforced*.
- The relevant US government agencies and the EU will be providing additional guidance in the near future, so be prepared for developments on this front.

Background on the Joint Plan of Action

On November 14, 2013, the IAEA, a Vienna-based nuclear watchdog, issued its most recent report regarding the implementation of the non-proliferation treaty safeguards relating to Iran's nuclear weapons program. This report, in part, facilitated renewed discussions between Iran and the P5+1 that led to the JPA agreement.

The JPA proposes to lift certain secondary sanctions for a period of six months (the "Negotiations Period") and includes significant limits on Iran's nuclear program that begin to address the international community's most urgent concerns, including Iran's enrichment capabilities: its existing stockpiles of enriched uranium, the number and capabilities of its centrifuges, and its ability to produce weapons-grade plutonium using the Arak reactor. The JPA is also designed to prevent Iran from using the cover of the Negotiations Period to continue advancing its nuclear weapons program.

Parsing Key Provisions of the JPA

Any sanctions relief provided by the P5+1, we believe, is intended to occur only after: (1) the terms and conditions embodied in the JPA have become effective; and (2) Iran has fulfilled all of its obligations under the JPA. Any temporary relief identified below is therefore contingent upon Iran in fact doing what it has agreed to do and such actions being verified by the IAEA. We understand that the relevant US government authorities will give sufficient and clear notice when Iran has complied with its JPA obligations.

We further understand that the proposed sanctions relief will not apply to US persons, and US companies and their US and non-US subsidiaries will continue to be unable to transact with Iran. While a more comprehensive plan, if it is reached during the Negotiations Period, may provide for some limited sanctions relief for US companies, in the interim, US companies continue to be restricted in their transactions and any engagement with Iran.

The sanctions relief contemplated by the JPA may provide certain non-US companies with limited ability to conduct certain transactions with Iran, as described below. However, these countries shall remain subject to the sanctions laws of their respective jurisdictions and the EU sanctions laws, if those apply. As described further below, however, we expect the EU to

provide roughly synonymous sanctions relief.

According to the terms of the JPA, the P5+1 agreed to certain “limited, temporary, and reversible relief,” such as:

- Suspending the imposition of any new nuclear-related sanctions for six months, if Iran abides by its commitments;
- Suspending certain sanctions on (i) gold and precious metals, (ii) Iran’s auto sector, and (iii) Iran’s petrochemical exports;
- Allowing for limited safety-related repairs and inspections made inside Iran for certain Iranian airlines;
- Freezing the sales of Iranian oil at their current significantly reduced levels;
- Permitting \$400 million in governmental tuition assistance to be transferred from restricted Iranian funds to recognized educational institutions in third countries, to defray the tuition costs of Iranian students; and
- Facilitating humanitarian transactions that are already allowed by US law, including those related to Iran’s purchase of food, agricultural commodities, medicine and medical devices, as well as transactions for medical expenses incurred abroad.

Generally, the proposed relief measures are structured so that the overwhelming majority of the sanctions regime, including key sanctions targeting Iran’s energy (oil & gas), banking, and financial sectors, remain in full force and effect throughout the Negotiations Period. Indeed, we understand that only certain secondary sanctions, or those sanctions targeting non-US persons or non-US countries and *not* US persons, will be eased for six months. In other words, from a US perspective, these temporary measures will not impact the status quo. US persons and subsidiaries of US persons are and will continue to be prohibited (unless expressly authorized) from doing any business with Iran.

The JPA’s Impact on Non-US Persons

As to non-US persons, the JPA proposes limited temporary measures that we anticipate would allow certain limited transactions with Iran. However, the majority of sanctions, including those enforced under the Iran Sanctions Act and Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010, will remain in effect. We should further note that none of the relief measures under the JPA contemplate authorizing any business dealings with specially designated nationals and blocked persons. In anticipation of these proposed measures being implemented, we discuss below the likely impact the JPA could have on key industry sectors for non-US persons, if Iran satisfies the prerequisites.

Energy & Petrochemicals Sectors

Pursuant to the JPA, Iran’s crude oil sales are locked in at the present rate for the next six months and limited to the six present importers. Accordingly, only the countries that currently buy oil from Iran (China (including Taiwan), India, Japan, South Korea, and Turkey) can continue to buy oil from Iran and only at the current volume and pricing.

Consequently, there will likely be a suspending of sanctions imposed on non-US companies involved in the shipping and transport of Iranian oil products to these six countries. But if a country is not currently importing oil from Iran, it cannot begin to import oil from Iran. We also anticipate that there will be no lifting of any secondary sanctions relating to the carrying of crude oil outside of these countries. Likewise, the EU’s crude oil ban is expected to remain in effect, as will sanctions affecting petroleum product exports from Iran.

Similar to the sanctions relief for oil, certain sanctions related to Iran’s export of petrochemicals to non-US persons will also be suspended and will include a suspension of certain sanctions related to non-US companies financing, insuring,

shipping, and transporting the permitted petrochemical exports. However, we believe this suspension will also be limited, and it will not permit exports of petrochemical products to Iran.

Financial Services Sector

As to the financial services sector, sanctions against the Central Bank of Iran and approximately two-dozen Iranian banks and financial institutions will remain in place. The vast majority of Iran's approximately \$100 billion in foreign exchange holdings will also continue to be inaccessible or restricted by sanctions. But \$4.2 billion from continued oil sales noted above will be allowed to be transferred in installments if and as Iran fulfills its commitments. These transfers will involve the release of funds held by non-US financial institutions and not by any US financial institutions.

Automotive Sector

The JPA contemplates the suspension of current secondary sanctions imposed by the US pursuant to Executive Order 13645, which prohibits the "sale, supply, or transfer to Iran of significant goods or services used in connection with the automotive sector of Iran" and related financial dealings. The JPA also contemplates temporary licensing to permit the supply of aircraft spare parts to Iran as well as the provision of related services to repair civilian aircraft for safety purposes and would also include "associated services." We believe that this temporary licensing may be the only area in which limited sanctions relief may be extended to US persons. Outside of these two modifications to the sanctions regime, we anticipate that there will be no other alterations to any Iranian trade sanctions.

The International Community's Perspective

Like the US, the EU has not yet implemented any aspect of the JPA. Nevertheless, we anticipate that the EU will increase the authorization thresholds for financial transactions for humanitarian and non-sanctioned trade with Iran, thereby making it easier to fall within applicable exemptions.

We also understand that the UK has indicated that implementation will begin following technical discussions with Iran and the IAEA and EU preparations to suspend the relevant sanctions, which is expected to be concluded by the end of January 2014.

Similarly, the French Foreign Minister, Laurent Fabius, has stated that EU foreign ministers would gather together in "a few weeks" to discuss lifting some sanctions as part of the deal—a move he said could take place "in December." Minister Fabius has not indicated specifically which sanctions would be lifted. Although his remarks were widely reported in the media, no official statement of such a meeting has been released.

Nothing in the JPA as yet changes the status quo with respect to applicable EU legislation, and visibility on any amendments to the sanction regime is expected in January 2014. However, we expect that the P5+1 will, during this interim process, coordinate any modifications of their respective sanctions programs.

Next Steps

The immediate next step is to await the *actual* implementation of the JPA and additional guidance that will be likely forthcoming from the P5+1 detailing exactly what will be suspended.

In addition, as is plain on the face of the JPA, the proposed suspensions are only intended to be interim measures on the road to a possible comprehensive resolution. As a practical matter, any next steps are largely contingent upon how Iran honors its initial commitments to the P5+1. We expect that the P5+1 will be leery and hesitant to fully trust Iran as evidenced by the US Government's mantra that "nothing is agreed until everything is agreed," not to mention US Congress' seeming inability to stop proposing new and more restrictive measures. Similarly, although the EU and the

Member State governments may be slightly more expansive in their suspension of sanctions, those measures, too, will be at best incremental and temporary.

As a result, even though companies (US and non-US) may view with anticipation the possibility of being able once again to do business with Iran, that day is not yet here and businesses seeking to move quickly must do so with (1) caution, (2) close attention to the intricacies of existing regulations and future modifications to them, and (3) a clear strategy should the JPA crash and burn.

We should also note that members of US Congress have already proposed legislation, titled the Iran Nuclear Compliance Act of 2013, to address what happens if (and to some when) Iran is deemed to be non-compliant in any substantive measure during the Negotiations Period. Key provisions include:

- Requiring the President to “reinstate all sanctions relief within 15 days of receiving credible and accurate information that Iran is not fully complying” with the JPA;
- Requiring a “snapback of all sanctions relief” if Iran does not comply with all appropriate IAEA inspection requests;
- Preventing the JPA from becoming a final deal by “requiring a full snapback of all sanctions relief after eight months in the absence of an appropriate final deal”; and
- Proposing a number of “basic conditions” before any final long-term comprehensive agreement could be reached, including:
 - full suspension of all uranium enrichment and reprocessing activities;
 - full suspension of all heavy-water (plutonium-related) activities;
 - a cessation of all construction of uranium enrichment and heavy-water facilities;
 - full compliance with the IAEA’s monitoring and inspection activities;
 - full access to certain military nuclear-related facilities;
 - full suspension of ballistic missile and nuclear delivery activities;
 - a full accounting of all nuclear weaponization activities; and
 - full suspension of all nuclear weaponization activities.

Practical Tips

- *Stay tuned.* Any contemplated sanctions relief has not gone into effect and will only go into effect after Iran has fulfilled its obligations. The US Government will provide notice about when and how certain sanctions will be suspended.
- *Proceed with caution.* US companies and their US and non-US subsidiaries are still prohibited from doing business with Iran. Non-US companies should continue to be extremely cautious in what types of business dealings they engage in with Iran, particularly since we understand that the US Government will continue to vigorously enforce those sanctions that remain in place. Further, the relief measures provided for in the JPA represent only a preliminary, temporary, limited, and reversible step on the road to a possible comprehensive resolution; even if more steps are taken down this road, any further relief will likely be similarly limited and reversible and premised on Iran’s completion of defined benchmarks.

- ***Await guidance.*** Persons seeking to submit an application based on the proposed or planned interim measures should await further guidance from the relevant P5+1 governmental entity, as we suspect no license application will be substantively reviewed until such entity has issued further guidance.
- ***Our website.*** We will post to our website key Iran sanctions documents in the near future and will update you on key developments from time to time.

As always, please feel free to call any of the partners listed above or your regular Shearman contact if you would like to discuss the JPA, its implications, or economic sanctions compliance in general.

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This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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