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Six Months After Implementation of Iran Nuclear Agreement: Top 10 Observations

Various factors continue to shape and limit trade and investment between Iran and the rest of the world.

Six months have passed since the implementation of the nuclear agreement with Iran, officially known as the Joint Comprehensive Plan of Action (the Nuclear Agreement), and the related easing of certain trade and economic sanctions on Iran. As discussed below, some changes to US sanctions have yet to be fully implemented; US and non-US firms continue to face significant compliance challenges and enforcement risks; and international banks and financial institutions remain reluctant to finance business with Iran in the face of lingering legal, reputational and business risks.

1. Changes to US and EU Sanctions Upon Implementation of the Nuclear Agreement

On January 16, 2016, the United States, European Union and United Nations eased or lifted certain nuclear-related sanctions against Iran. As described in more detail in our *Client Alert* of January 19, 2016, changes to the sanctions included the following:

- The US suspended most of its nuclear-related "secondary" sanctions that were designed to prevent non-US parties from engaging in certain activities involving Iran, including trade and investment in Iran's energy, financial services and shipping sectors.
- The US Treasury Department's Office of Foreign Assets Control (OFAC) issued General License H, authorizing US-owned or controlled entities outside the United States to do business with Iran, subject to several significant limitations.
- OFAC expanded a Specific Licensing Policy, allowing OFAC to issue transaction-specific licenses for the export, re-export, sale, lease or transfer of commercial passenger aircraft and related parts and services to Iran for commercial passenger aviation.
- The EU revoked most of its sanctions against Iran, but left in place targeted controls on exports to Iran of certain items as well as EU asset freezes on certain Iranian parties, including designated Iranian banks.

Significantly, the US has kept in force the core of its longstanding "primary" sanctions against Iran, which generally prohibit US persons from engaging in non-authorized trade and business involving Iran, Iranian entities and Iranian products.

2. Interpretive Guidance from OFAC on US Sanctions Changes

On Implementation Day, OFAC issued a number of Frequently Asked Questions relating to the lifting of certain US sanctions. In response to further questions from the private sector, OFAC updated the FAQs in June 2016. The new guidance addresses the following points:

- For US person employees, managers, executives or board members of either the foreign affiliate of a US company or a non-US company, such persons must be "walled off" or "ring-fenced" from Iran-related business. This is because US persons continue under the primary sanctions to be broadly prohibited from engaging in or facilitating transactions or dealings with Iran. As OFAC notes, "[t]he prohibitions on the exportation or reexportation of services to Iran and facilitation have been in place for decades, and are consistent with prohibitions applied across a range of U.S. sanctions programs administered by OFAC." This effectively permits formal recusals for US persons, though OFAC suggests "blanket" recusal policies requiring that all US persons not be involved in Iran-related activities as opposed to case-by-case abstentions. OFAC has also confirmed that US persons can engage in limited activities related to establishing or altering policies and procedures "to the extent necessary" to allow foreign affiliates to engage in Iran transactions authorized under General License H.

- OFAC has also clarified how to determine whether an entity established outside the United States is "owned or controlled by a United States person" (quoting from 31 CFR § 560.215), and thus eligible to use General License H. For ownership, OFAC will generally aggregate the interests of multiple US persons in determining whether one or more US persons holds a 50% or greater equity interest (by vote or value) in or a majority of seats on the entity's board of directors. In determining whether an entity is controlled by one or more US persons, OFAC prescribes a "fact-specific, case-by-case" analysis, focusing on "the aggregated ownership interests held, and indicia of control exercised, by all relevant US persons." But OFAC will not consider a non-US publicly traded entity or a foreign entity in which "ownership interests are otherwise widely disbursed" to be owned or controlled by a US person if US persons, in the aggregate, passively hold more than 50% of the shares but no one US person holds a controlling share in the company.

- US persons changing policies and procedures to the extent necessary to allow a foreign affiliate to act under General License H can take such action more than once, provided the changes are not in response to or intended to facilitate any particular Iran-related transaction. In addition, US companies (including their US personnel) are not barred from supporting the day-to-day operations of a foreign subsidiary that takes advantage of General License H, as long as their actions are not tied to any of the foreign affiliate's transactions or dealings with Iran. Along the same lines, a US company and its US personnel can receive after-the-fact information concerning a foreign affiliate's business with Iran under General License H, but they "cannot attempt to influence Iran-related business decisions of such entities based on such reports."

- OFAC has also clarified that a US company can alter its policies and procedures, as well as those of its owned or controlled foreign affiliates, to allow the foreign affiliate to establish a physical presence in Iran. That said, the foreign affiliate with a presence in Iran must continue to comply with remaining US prohibitions on the export, re-export, sale or supply — directly or indirectly — of goods, technology or services.

3. Banks and Financial Institutions Face Significant Remaining Hurdles With Respect to Iran

Notwithstanding the changes to the EU and US sanctions, international banks and financial institutions are generally continuing to exercise significant restraint with respect to Iran. Even though sanctions have been eased to allow broad categories of transactions, including financial transactions (particularly by non-US banks), involving Iran, the global banking sector still faces considerable legal, business and reputational risks associated with the Iranian market.

The most significant hurdle for the banking sector is continuing US prohibitions on the processing of payments involving Iran through the US banking system. These continuing prohibitions effectively prevent US banks from handling or processing payments or US dollar-clearing that relate to Iran, unless those activities are limited to the narrow slice of transactions authorized as to US persons (such as medicine and medical device exports, but not General License H transactions). This means that the US banking system is essentially off limits to payment flows involving Iran, even in situations where the underlying transactions do not involve US persons and are beyond the scope of US sanctions.

As a result, even non-US banks and financial institutions are extremely skittish about dealings with Iran. This is based both on the risks they must manage to ensure their own compliance with remaining US (and EU) sanctions laws, and the extremely aggressive US enforcement climate that has in recent years yielded criminal penalties in the billions of dollars for non-US banks. In managing their compliance risks, non-US banks generally need to prevent Iran-related payment flows from entering the US banking system (by not handling Iran-related transactions in US dollars, for example), while at the same time ensuring that they are not dealing with any Iranian parties that remain subject to US or EU sanctions. The cost of case-by-case compliance reviews can be significant, and, in light of the recent penalties cases against banks, the cost of compliance failures can be catastrophic.

Beyond the compliance and enforcement challenges described above, global banks face additional challenges and risks regarding the Iranian market. These include concerns about terrorist financing, money laundering, and a general lack of transparency in the Iranian banking system. In December 2015, Adam Szubin, Acting US Treasury Undersecretary for Terrorism and Financial Intelligence, cautioned financial institutions about the importance of conducting extensive due diligence, warning that "Iran suffers from a serious lack of anti-money laundering controls, and therefore presents substantial money laundering and terrorist-financing risk." The Financial Action Task Force — an inter-governmental organization that sets standards to combat money laundering, corruption and terrorist financing — has classified Iran as a "high-risk and non-cooperative jurisdiction," and indicated in February 2016 that the task force was "exceptionally concerned about Iran's failure to address the risk of terrorist financing." Moreover, since 2011, the US Treasury Department has designated Iran a primary money-laundering concern, noting that "the international financial system [is] increasingly vulnerable to the risk that otherwise responsible financial institutions will unwittingly participate in Iran's illicit activities." In addition, Iran ranks 130 (out of 168) in terms of corruption perception on Transparency International's Corruption Perceptions Index.

In light of these continuing challenges, and related reputational risks, several banks and financial institutions have announced they have no current plans to re-enter the Iranian market. This reticence is in turn making it more difficult for firms to conduct now-permitted trade and business with Iran, frustrating the Iranian government's desire to reap economic benefits from the easing of sanctions, and will likely continue to impede even lawful business with Iran for some time.

4. OFAC Issues General Licenses for Certain Transactions Involving Civil Aircraft

General License I, issued by OFAC on March 24, 2016, authorizes US persons to enter into contingent contracts relating to the export, re-export, sale, lease or transfer of commercial passenger aircraft and related parts and services to Iran for commercial passenger aviation. The general license also authorizes US persons to engage in transactions that are ordinarily incident to the negotiation of and the entry into such contingent contracts. Contingent contracts include "executory contracts, executory pro forma invoices, agreements in principle, executory offers capable of acceptance such as bids or proposals in response to public tenders, binding memoranda of understanding, or any other similar agreement." The contingency is that contract performance can only occur after the US person has received the necessary specific license from OFAC. OFAC also confirmed that General License I allows US persons to sign nondisclosure agreements in connection with the negotiation of a contingent contract for activities relating to the contemplated export or re-export of commercial passenger aircraft and/or related parts or services to Iran.

General License I does not authorize transactions with an airline or other person on the OFAC List of Specially Designated Nationals, such as Mahan Air. Such parties are also ineligible for the favorable licensing policy described in item 5 below.

General License I is an important development because it effectively avoids the need to secure two specific licenses from OFAC — one to negotiate and sign even a contingent contract, and another to perform under the contract. OFAC acknowledged in its FAQs that the new General License "will allow for more efficient processing of specific license applications for the export or re-export to Iran of commercial passenger aircraft and related parts and services." Non-US persons are allowed to enter into contingent contracts without OFAC's approval, but the non-US person's performance under the contract may itself require OFAC approval, such as when performance relates to the sale and delivery of a US-regulated aircraft or aircraft parts to Iran.

On July 29, 2016, OFAC released General License J, authorizing the temporary sojourn to Iran — for no more than 72 hours — of certain non-US-registered, fixed-wing civil aircraft. This general license fills a longstanding void in the US export control system, which did not previously authorize commercial aircraft of US origin, or with more than 10% US-controlled content, to fly to Iran even on a temporary basis, absent OFAC licensing.

General License J comes with a number of limitations. For instance, the general license does not apply to helicopters, unmanned or optionally-piloted aircraft. Eligible aircraft cannot be equipped with or used to transport military equipment, items related to weapons of mass destruction, or ballistic missiles. Further, non-US re-exporters of eligible aircraft must satisfy a number of the same conditions found in the aircraft temporary sojourn License Exception in the Export Administration Regulations (15 CFR § 740.15(a)). The general license does not authorize the storage of aircraft equipment, spare parts, components, or technology in Iran, other than onboard the aircraft while temporarily in Iran.

General License J includes a narrow provision allowing for the re-export by a non-US person of certain US technology or know-how to Iran for emergency maintenance on temporary sojourn aircraft, but only to the extent needed to restore the aircraft to an airworthy condition. Notably, the general license does not apply to the temporary sojourn of US-registered aircraft or any transactions by or involving a US person (unless separately licensed by OFAC). Non-US-registered aircraft that have traveled lawfully to Iran on temporary sojourn under General License J, however, will not be considered to have entered Iranian

commerce. Absent this confirmation, the aircraft would otherwise be off-limits to US persons because the aircraft would be regarded as "goods of Iranian origin."

5. OFAC's Implementation of Specific Licensing Policy for Commercial Aircraft is Cumbersome and Under Congressional Scrutiny

Upon implementation of the Nuclear Agreement in January, OFAC issued a Statement of Licensing Policy, which paved the way for US persons and non-US persons to apply for OFAC licensing to export, re-export, sell, lease or transfer commercial passenger aircraft and related parts and services to Iran. (Non-US persons need such authorization before selling or exporting to Iran aircraft or related items that are subject to US export control jurisdiction, including foreign-made commercial aircraft with 10% or more US-controlled content.) Consistent with the terms of the Nuclear Agreement, this licensing policy extends only to items used exclusively for commercial passenger aviation.

In our *Client Alert* of January 19, 2016, we questioned how OFAC would manage these specific license requests, and cautioned that OFAC has not been known for speedy processing of specific licenses under other sanctions programs. To date, our understanding is that OFAC has in fact issued few licenses under this program, and we have seen no evidence of licenses approving the sale of complete commercial passenger aircraft to Iran.

In addition, several legislative proposals have been offered in the US Congress to prevent or further limit the sale of commercial passenger aircraft to Iran, notwithstanding a US commitment in the Nuclear Agreement to allow sales of qualifying items through a licensing process. Some of these legislative proposals were discussed at a House Financial Services Subcommittee hearing held on July 7, 2016, entitled The Implications of U.S. Aircraft Sales to Iran.

6. Measures by US States Continue Despite the Nuclear Agreement

State-level sanctions further complicate the landscape after the Nuclear Agreement, and they can create challenges for non-US as well as US firms. Currently, over 30 states (including the District of Columbia) maintain restrictions directed at companies that do business with Iran. These measures can ban such companies from receiving government contracts or state funds (*e.g.*, state pension funds).

Under Article 25 of the Nuclear Agreement, the US committed to "actively encourage" state officials to consider the changes in US policy under the Nuclear Agreement, and to refrain from taking or continuing actions inconsistent with that change in policy. Further to this commitment, the US Department of State sent letters to state governors encouraging them to reconsider any sanctions against Iran. But some state governors, including Governor Greg Abbott of Texas, have pushed back.

Companies should continue to monitor the potential impact of these state-level measures in evaluating business opportunities regarding Iran.

7. Contractual Protections for Potential "Snap-Back" of Sanctions Remain Critical

Under the terms of the Nuclear Agreement, UN, US and EU sanctions can be "snapped back" or re-imposed if Iran does not fulfill its nuclear-related commitments. OFAC guidance states that contracts signed prior to a snapback will not be grandfathered, and thus transactions conducted after a snapback "could be sanctionable to the extent they implicate activity for which sanctions have been re-imposed." Conversely, EU Council Regulation 2015/1861 provides that "adequate protection will be provided for the execution of contracts concluded whilst the sanctions were lifted."

Aside from the possibility that suspended sanctions could be snapped back, Iran faces the risk of new or expanded sanctions in response to its reported continuing ballistic missile testing. Although the Nuclear Agreement does not address ballistic missile testing, a Security Council Resolution approved in tandem with the agreement prohibits Iran from testing "ballistic missiles capable of delivering nuclear warheads." Since implementation of the Nuclear Agreement, OFAC has twice imposed additional sanctions on parties reported to be involved with Iran's ballistic missile program, first on January 17 and then on March 24.

The risk of a snapback or the imposition of new sanctions underscores the importance of strong contractual protections in dealings with Iran.

8. Update on the Visa Waiver Travel Restrictions for Iran Travel

As we reported in January, the US amended its Visa Waiver Program (VWP) — which allows nationals of 38 countries to enter the US visa-free for up to 90 days as a business visitor or tourist — to require a travel visa issued by a US embassy or consulate abroad, if the VWP-eligible foreign traveler has visited Iraq, Iran, Syria or Sudan since March 2011, or if the traveler has dual-nationality with any such country. In February 2016, the Department of Homeland Security (DHS) added the following question to the VWP application process pursuant to the Electronic System For Travel Authorization (ESTA): "Have you traveled to, or been present in, Iraq, Syria, Iran, or Sudan on or after March 1, 2011?"

The US Department of State announced that, under certain circumstances, DHS could waive this restriction on a case-by-case basis if, among other reasons, the (a) waiver was in the US law enforcement or national security interest, and (b) individuals had traveled to Iran for "legitimate business-related purposes" under the Nuclear Agreement. Whether DHS has been issuing this type of waiver is unclear. In its FAQ, DHS explains that VWP-eligible foreign travelers do not have to apply separately for a waiver based on the exception for legitimate business-related purposes under the Nuclear Agreement. Rather, DHS advises that whether a VWP traveler is eligible for this type of waiver will be determined on a case-by-case basis as part of the ESTA process. For a VWP-eligible foreign traveler answering yes to the question about prior travel to Iran as part of the ESTA process, there are anecdotal reports of such travelers having to submit tourism or business visa requests to US embassies and consulates — a process that can take several weeks.

9. Potential Impact of the US Presidential Election on the Iran Nuclear Agreement

The US Presidential campaign has highlighted another layer of uncertainty for the future of the Nuclear Agreement. While the Democratic Party's nominee, Hillary Clinton, has promised to uphold the terms of the Nuclear Agreement (which she initially helped to launch as Secretary of State) with "vigorous enforcement," there continues to be strong bi-partisan support for maintaining existing sanctions on Iran and taking a tough stance on Iran with respect to international terrorism and Iran's military and ballistic missile activities. These pressures could certainly lead to expanded sanctions on Iran, even under a Clinton presidency.

The Republican Party has consistently attacked the Iran Nuclear Agreement and promised to reject or at least renegotiate the agreement under a Republican presidency. Republican Senators and members of Congress have challenged the legal authority for the Agreement and tried to prevent its implementation, including through the recent efforts described above to challenge the issuance of licenses for commercial aircraft exports to Iran. Republican presidential nominee Donald Trump has repeatedly criticized the Nuclear Agreement. He stated before the American Israel Public Affairs Committee (AIPAC) in March of 2016 that his "number one priority is to dismantle the disastrous deal with Iran."

10. SEC Issuers and Affiliates Still Required to Disclosure Certain Iran-related Activities

Notwithstanding the Nuclear Agreement and the accompanying changes to US sanctions, publicly listed entities are still subject to an Iran-related disclosure requirement in place since 2013 under Section 13(r) of the Security Exchange Act. Among other instances, disclosure is required when the US or non-US issuer, or their affiliates, during the period covered by the annual or quarterly report to the SEC have knowingly conducted a transaction or dealing with (a) a party designated under US Executive Orders relating to WMD proliferators or terrorism (*e.g.*, Bank Saderat, Mehr Bank and Mahan Air), or (b) "without the specific authorization of a Federal department or agency," conducted any transaction or dealing with the Government of Iran. For these purposes, the Government of Iran is defined to include its political subdivisions, agencies, instrumentalities, the Central Bank of Iran, and any person owned or controlled by the foregoing or acting on its behalf (*e.g.*, state-owned or controlled banks, hospitals or other parties identified on the Executive Order 13599 List).

Conclusion

In the face of political uncertainty and continuing pressure to take a hard stance on trade and business with Iran, particularly in the United States, it is prudent to assume that remaining US sanctions will stand for some time and continue to be aggressively enforced, and there is some risk that new sanctions could be implemented. These risks and other factors will continue to present hurdles for global businesses seeking to enter the Iranian market, and impede the economic benefits that global businesses and the Iranian people have been looking to realize from the Nuclear Agreement.

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