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Client Alert: Doing Business with Iran after the US's Withdrawal from the Nuclear Deal

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When US President Donald Trump announced in May 2018 that the US administration would cease implementing the U.S. commitments under the "Nuclear Deal" with Iran, this hardly came as a surprise. Yet, several weeks down the road and the re-imposition of US sanctions on the way, many European companies with commercial ties to Iran are still in the process of figuring out what to do. The EU's announcement that it would amend the 1996 EU Blocking Statute as a countermeasure has added an additional layer of complexity.

This client alert discusses issues related to existing contracts with Iranian parties and investments in Iran. Importantly, the re-imposition of US sanctions will not render all business activity in Iran prohibited under US law for European companies. However, dealing with Iranian counterparties will become significantly more difficult than it is today. This will lead many companies to decide to wind down their Iran activities. Those determined to stay may have to devise new ways to minimize disruption to their business, particularly regarding payment and delivery networks.

What is the Status of the Joint Comprehensive Plan of Action?

To recap: On 14 July 2015, the Islamic Republic of Iran and the E3/EU+3 (China, France, Germany, the Russian Federation, the United Kingdom, the United States, and the High Representative of the European Union) agreed the Joint Comprehensive Plan of Action ("**JCPOA**"), also referred to as the "Nuclear Deal", under which the E3/EU+3 agreed to lift and/or waive numerous sanctions in exchange for Iran curtailing its nuclear program. On 20 July 2015, the UN Security Council unanimously passed Resolution 2231 (2015) endorsing the JCPOA, which was incorporated in its Annex in full. In accordance with the JCPOA's detailed implementation calendar, sanctions were lifted or waived on 16 January 2016, the "**Implementation day**".

Following repeated statements in 2016 and 2017, President Donald Trump announced on 8 May 2018 that his administration would cease implementing U.S. commitments under the JCPOA and discontinue the US sanction's waivers in place since Implementation Day. The waived US sanctions are to become effective again, following a 90- or 180-day wind down period depending on the type of activity involved, on August 6 or November 4, 2018 respectively.

The US decision does not "terminate the JCPOA" in a legal sense. The remaining parties, including Iran, have announced that they will continue to comply by its provisions, although Iran made its assurances conditional on reaping continued economic benefits from the JCPOA. The JCPOA is an unusual accord in so far as it was not signed as an international treaty between Iran and the E3/EU+3. It does not include an explicit withdrawal provision,

though it does include a dispute resolution mechanism, which would have allowed the US to cease implementing its JCPOA commitments in certain circumstances. The US administration, though, chose not to use that mechanism. The mechanism would have involved filing evidence that Iran is in breach of the JCPOA.

The US administration has consistently held that the JCPOA is a non-binding political commitment. Conversely, European state parties, diplomats and commentators have maintained that UN Security Council Resolution 2231 renders the JCPOA binding on all parties under the UN Charter, and accordingly the US withdrawal a violation of international law. Whatever the correct assessment, the re-imposition of US sanctions is set to severely impact non-US companies' dealings with Iran.

What is the Effect of the US withdrawal from the JCPOA?

The US's withdrawal from the JCPOA will have the effect that the sanction regime in existence prior to the Implementation Day will revive. The US sanction regime consists of primary and secondary sanctions, and most of the sanctions waived under the JCPOA are secondary sanctions. Primary sanctions apply to any "US Person," which in most US sanction regulations means any United States citizen, permanent resident alien, entity organized under the laws of the United States or any jurisdiction within the United States (including foreign branches), or any person in the United States (even if only temporarily) (*see e.g.* 31 CFR 560.314). But for a few exceptions (see section 5, Annex II, JCPOA), primary sanctions remained largely unaffected by the JCPOA.

One of the US obligations under the JCPOA affecting US persons was the issuance of General License H, which allowed foreign entities owned or controlled by US persons to engage in otherwise prohibited transactions with Iran (*e.g.* 31 C.F.R. § 560.215). The objective was to ensure that an entity's U.S. ownership status would not disadvantage them in relation to their competitors. The US Department of the Treasury's Office of Foreign Assets Control ("**OFAC**") announced that it planned to revoke General License H.

A European enterprise that is not a foreign branch or controlled by a US person is not a US-person. Moreover, if a European company has a subsidiary or business interests in the US, this does not render that company a US-person. Only the respective US subsidiary is a US-Person and is subject to the primary sanctions on Iran.

What are the penalties for violating secondary sanctions?

Since 2010, the US sanctions regime has increasingly exercised its extraterritorial ambitions by seeking to regulate non-US persons through the use of far-reaching secondary sanctions. Secondary sanctions have worldwide coverage and are supposed to render every person and entity anywhere in the world subject to U.S. sanctions for engaging in certain activities or transactions with specified individuals, entities, or certain countries, such as Iran. They penalize non-U.S. persons or entities for dealing with Iran, even when there is no U.S. connection. Instead of imposing civil or criminal liability, penalties for violating secondary sanctions mainly involve cutting off the sanctioned person's access to the US market, among other things, by:

1. Denying the non-US person access to the US banking system;

2. Sanctioning or preventing senior management or shareholders of a non-US entity from entering the U.S; and/or

3. Freezing any property of a non-US person that is within or passing through US jurisdiction (*e.g.* U.S. dollar transfers).

Nevertheless, non-US persons may incur criminal and civil liability under certain circumstances for sanctions violations in accordance with the International Emergency Economic Powers Act (1977) ("**IEEPA**").

The IEEPA grants the US President wide-ranging power to issue executive orders that have the force of law. Various Iran-related Executive Orders (among others, 13574, 13590, 13622, 13628, and 13645) were issued pursuant to the IEEPA. Under section 206 of the IEEPA (50 U.S. Code § 1705), persons are subject to civil and criminal penalties for violating, attempting to violate, conspiring to violate or causing a violation of any sanction regulations (including applicable Executive Orders) enforced by OFAC.

The IEEPA is not limited to US persons. Thus, various US administrations have increasingly taken the view that any person tangentially subject to US jurisdiction, such as European companies with substantial US business, may be held liable under the IEEPA. This has been particularly true when they "cause" a U.S. person to violate the sanction regime. As of 15 January 2017, penalties range from a civil fine of $289,238 and higher or twice the amount of the transaction at issue, criminal penalties of up to $1 million per violation, and/or potential imprisonment of up to twenty (20) years per violation.

Certain relevant acts also impose Iran sanctions and explicitly incorporate section 206 of the IEEPA. These acts include the Comprehensive Iran Sanctions, Accountability, and Divestment Act (the "**CISADA**"), section 1245 of the National Defense Authorization Act for Fiscal Year 2012 (the "**NDAA**"), the Iran Freedom and Counterproliferation Act of 2012, and the Iran Threat Reduction and Syria Human Rights Act.

The US's obligations under the JCPOA primarily involve secondary sanctions directed at non-U.S. persons (except for those in section 5, Annex II, JCPOA). Accordingly, most re-imposed sanctions are the same as those applied to non-US persons prior to Implementation Day.

What are the secondary sanctions that will be re-imposed?

Unless the US reverses its decision, after the 90-day wind-down period ends on 6 August 2018, the following sanctions (including sanctions on associated services) will be re-imposed:

1. Sanctions on the purchase or acquisition of US dollar banknotes by the Government of Iran (section 4.1.3, Annex II, JCPOA);

2. Sanctions on significant transactions related to the purchase or sale of Iranian rials, or the maintenance of significant funds or accounts denominated in the Iranian rial outside the territory of Iran (section 4.1.2, Annex II, JCPOA);

3. Sanctions on Iran's trade in gold and precious metals (section 4.5, Annex II, JCPOA);

4. Sanctions on the direct or indirect sale, supply, or transfer to or from Iran of graphite, raw or semi-finished metals such as aluminum and steel, coal, and software for integrating industrial processes (section 4.6, Annex II, JCPOA);

5. Sanctions on the purchase, subscription to, or facilitation of the issuance of Iranian sovereign debt (section 4.1.5, Annex II, JCPOA); and

6. Sanctions on Iran's automotive sector (section 4.7, Annex II, JCPOA).

Likewise, following the 180-day wind-down period ending on 4 November 2018, the U.S. administration will re-impose the following sanctions:

1. Sanctions on Iran's port operators, and shipping and shipbuilding sectors, including on the Islamic Republic of Iran Shipping Lines ("**IRISL**"), South Shipping Line Iran, and their affiliates (section 4.4, Annex II, JCPOA);

2. Sanctions on petroleum-related transactions with, among others, the National Iranian Oil Company ("**NIOC**"), Naftiran Intertrade Company ("**NICO**"), and National Iranian Tanker Company ("**NITC**"), including the purchase of petroleum, petroleum products, or petrochemical products from Iran (section 4.3, Annex II, JCPOA);

3. Sanctions on transactions by foreign financial institutions with the Central Bank of Iran and designated Iranian financial institutions (including Bank Melli Iran, Bank Sepah International Plc, Europäisch-Iranische Handelsbank AG, Export Development Bank of Iran, Melli Bank Plc, Post Bank of Iran) under Section 1245 of NDAA (section 4.1, Annex II, JCPOA);

4. Sanctions on the provision of specialized financial messaging services (such as SWIFT) to the Central Bank of Iran and Iranian financial institutions described in Section 104(c)(2)(E)(ii) of CISADA (4.1.6, Annex II, JCPOA);

5. Sanctions on the provision of underwriting services, insurance, and reinsurance (section 4.2, Annex II, JCPOA); and

6. Sanctions on Iran's energy sector (*e.g.* participation in joint ventures, goods, services, information, technology and technical expertise) (section 4.3.2, Annex II, JCPOA).

Associated services include technical assistance, training, insurance, re-insurance, brokering, transportation or financial services.

Moreover, entities removed from the OFAC's Specially Designated Nationals List ("**SDN List**") pursuant to JCPOA will be re-designated (section 4.1.1, Annex II, JCPOA). The US government has already started restoring persons and entities to the SDN List and is expected to continue. The mentioned executive orders have yet to be reinstated, but OFAC has announced their plans to do so.

The re-imposition of secondary sanctions does not mean that all trade with or investment in Iran is rendered prohibited under US law for European companies. But it will become more difficult, even in areas that are expressly excluded from the sanctions (*e.g.* agricultural commodities, food, medicine, or medical devices (*see* § 8512 B(2)(b), 22 U.S.C 92 (CISADA), § 8801, 22 U.S.C. 95 (Iran Freedom and Counterproliferation Act); § 8722, 22

U.S.C. 94 (Iran Threat Reduction and Syria Human Rights)). US sanctions, in conjunction with expected EU countermeasures, will create a complex regulatory landscape that will be difficult to navigate, especially for small- and medium-sized companies . Additionally, over-prudent self-regulation, particularly in the financial industry, is expected to suffocate trade with Iran.

What countermeasures are being taken by the EU?

Following President Trump's announcement of the US's withdrawal from JCPOA, several European companies immediately announced that they would pull out of Iran for fear of being penalized under the re-imposed sanctions. To protect European businesses with commercial ties to Iran, on 18 May 2018 the European Commission launched the formal process to re-activate Council Regulation (EC) No 2271/96 of 22 November 1996 (the "**Blocking Statute**") by updating the list of US sanctions on Iran that fall within its scope. The Blocking Statute forbids (with limited exceptions) EU persons from complying with US extraterritorial sanctions, allows companies to recover damages arising from such sanctions from the person causing them, and nullifies the effect in the EU of any foreign court judgements, decision or award based on the listed sanctions. The European Commission published a draft of the proposed amendments to the Blocking Statute on 6 June 2018. The EU aims to have the measure in force before 6 August 2018, when the first batch of US sanctions takes effect.

The EU also began the procedure to clear the path for the European Investment Bank ("**EIB**") to decide to finance activities in Iran under the EU budget guarantee. This will allow the EIB to support EU investment in Iran and is to be used for small- and medium-sized companies.

Moreover, on 15 May 2018, following ministerial meetings of the EU/E3 and Iran, Federica Mogherini, High Representative of the Union for Foreign Affairs and Security Policy, announced that the EU would find practical solutions to:

1. Maintain and deepen economic relations with Iran;
2. Continue the sale of Iran's petroleum and related products;
3. Allow effective banking transactions with Iran;
4. Continue sea, land, air and rail transportation relations with Iran;
5. Support the provision of export credit and development of special purpose vehicles in financial banking, insurance and trade areas;
6. Ensure further investments in Iran; and
7. Promote legal certainty and the protection of EU economic operators.

Overall, it's expected that the EU will issue further measures in the coming 90 days with the aim of neutralizing the effect of the US's actions, unless the US administration backs down.

It is difficult to assess whether the countermeasures, if implemented, will be effective. At this point in time, we are unconvinced that they will be, particularly in relation to the banking

sector. Business representatives will merely see a second layer of regulation, in addition to the US sanctions, that will further complicate doing business with Iran.

What will be the effect of sanctions on financial transactions?

Arranging payments for Iran-related transactions remained difficult even under the JCPOA. It is expected to become even more difficult in the future. Also, for transactions that are technically not affected by US sanctions, payment issues will remain a major impediment and may suffocate any business with Iran. In addition, it is likely that the foreign currency crisis in Iran will deteriorate, meaning that international companies working with Iranian partners are likely to face payment issues.

Even prior to 4 November 2018, any transactions to and from Iran is likely going to be more challenging as banks and other counterparties engage in de-risking by ending their involvement with Iran-related transactions. As of the date of this alert, we are aware that only a limited number of German saving banks still accept Iran transfers on a case-by-case basis. Even prior to the US's announcement, various European banks had entered into special agreements with the US Department of the Treasury to institute enhanced compliance measures following the latter's imposition of fines against banks for having violated US sanctions. Deutsche Bank was one of such institutions.

The Belgium-based Society for Worldwide Interbank Financial Telecommunication ("**SWIFT**") is the primary provider for transferring information about financial transactions between banks. In 2012, pursuant to US and EU sanctions, SWIFT disconnected Iranian banks from its messaging system. Under the JCPOA, SWIFT reconnected Iranian banks to allow for international banking transactions. The US administration has explicitly stated that it intends to cut off the Iranian banking system, which will likely involve trying to stop SWIFT from servicing Iranian banks. Thus far, SWIFT has maintained it would follow EU guidance and stressed that its "mission remains to be a global and neutral service provider to the financial industry." SWIFT noted that the ban would not come into effect until 4 November 2018 and that it would seek clarification from EU and US authorities until then.

The EU will likely try to prevent SWIFT from disconnecting Iranian banks as disconnecting may finish the JPCOA for good. US commentators have suggested that the US administration may decide to add the entire board of SWIFT to its SDN List or Foreign Evaders List, should it refuse to comply. It is unlikely that such a move would sit well with the EU. At this moment in time, it is unclear what, if any, actions SWIFT will take. However, there is a possibility that SWIFT will be a point of major contention in US and European negotiations going forward.

Aside from this issue, we note that the re-imposition of sanctions is bound to impair the settlement of any transactions through SWIFT in *US dollars* as such payments involve the US financial system. We expect that this will further impair money transfers to and from Iran, although cryptocurrency provides a potential alternative avenue. Iranian parties still appear to be able to obtain cryptocurrency via the use of decentralized cryptocurrency exchanges or mining.

What will be the effect of sanctions on existing contracts?

According to OFAC guidance, all activities that will again be subject to sanctions must cease within the respective 90- or 180-day wind-down periods. This includes the provision or delivery of goods or services and/or extension of loans or credits to an Iranian counterparty pursuant to written contracts entered into prior to 8 May 2018.

Accordingly, to comply with US sanctions, any sanction-able activity must cease, irrespective of whether doing so will put the party in breach of contract. However, where a non-US non-Iranian party is owed payment after the conclusion of the wind-down period pursuant to a written contract entered into prior to 8 May 2018 for goods or services provided or delivered to an Iranian counterparty before the wind-down dates, the party may receive payment under such contract. The same applies to the repayment of loans or credits extended under written contract prior to 8 May 2018 by non-US non-Iranian parties to Iranian counterparties.

Significantly, however, after the wind-down dates, payment to *Iranian* parties for sanctioned transactions will no longer be allowed. Such situations include any re-payment that is due to an Iranian party following the unravelling of a subject transaction to ensure compliance with US sanctions. For example, where an Iranian party prepays a supplier under a supply contract, but the non-Iranian supplier is unable to deliver (even if unexpectedly) prior to the re-imposition of sanctions, the payment cannot be returned after the wind-down dates, even if no delivery took place.

Transactions under new contracts with Iranian parties that will be subject to sanctions after the wind-down periods are still possible, so long as they are completed prior to those deadlines. However, the sunset provisions for payment do not apply to these transactions. Moreover, OFAC implied that the willingness of a company to enter into soon-to-be sanction-able transactions would be considered when evaluating actual violations.

Overall, we note that the way the sanctions will be re-imposed depends largely on the attitude of the OFAC, which is responsible for implementing the sanctions. The OFAC has a lot of leeway to shape which international companies will be hit by secondary sanctions and how strictly it will apply those sanctions. However, based on the reaction of several financial institutions and other European companies, we expect that many businesses will follow a maximalist approach to self-regulation, independent of whatever approach OFAC choses. In view of the severe fines the US government have levied on European banks in the past, this is especially likely to be the case for European financial institutions.

Will the re-imposition of sanctions be a cause of force majeure for existing contracts?

We consider it unlikely that a company can successfully invoke force majeure for the re-imposition of US sanctions, unless the scenario is explicitly mentioned as a force majeure event in the respective contract.

The lack of foreseeability is usually a condition for invoking force majeure in many legal systems, and sanctions, including trade restrictions, are a typical case of force majeure. The situation at hand, however, is atypical insofar as companies doing business with Iran since Implementation Day were aware of the risk of “snapback” sanctions under the dispute resolution mechanism of the JCPOA. Although the present sanctions are not snapback

sanctions, their possibility and President Trump's previous announcements that the US will withdraw from the JCPOA, make it difficult to argue that the respective measures were not foreseeable. It may still be possible to argue that, although the US's re-imposition of sanctions was foreseeable in the event Iran were to violate of its obligations under JCPOA, it was unprecedented that the US would withdraw completely without a proven violation.

We also do not expect that the Iranian courts or the Iranian administration will recognize any trade restrictions or sanctions imposed by the US. From what we can determine, the Iranian government considers the re-imposition of the US sanctions to be illegitimate. Therefore, it is unlikely that an Iranian court would give effect to the respective measures. Even if US sanctions prevent an international company from executing a contract with an Iranian counterpart, the breach will not be excused, from the perspective of Iranian law, because the respective sanction will not be recognized. The same applies from the European perspective, as soon as the EU has enacted the Blocking Statute's amendments.

If you would like more information about this topic, please contact us.

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