

Implementation Day: Ready? Or Not?

By [Hamilton Loeb](#) and [Scott M. Flicker](#)

The certification called for by the agreement came in, detainees were released, and all the U.S. sanctions against Iran were removed.

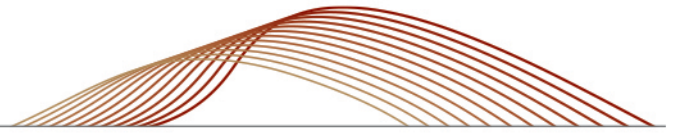
Thirty-five years ago – almost to the day – that’s how it worked. The Algiers Accord, the agreement that resolved the American hostage trauma in Tehran, called for the Government of Algeria – which had hosted the secret negotiations and brokered the January 1981 deal between the U.S. and Iran – to certify “that the 52 U.S. nationals ha[d] safely departed from Iran,” upon which event the U.S. would “revoke all trade sanctions” imposed against Iran in the wake of the seizure of the American embassy and staff fourteen months earlier.

Not so simple this time.

The International Atomic Energy Agency (“IAEA”) has now issued its formal verification that Iran has implemented the list of a dozen steps specified by last July’s Vienna Agreement to constrain the Iranian nuclear program.¹ The IAEA’s verification triggers the implementation of undertakings by the U.S., the E.U. and the U.N. to terminate – or to “cease the application of” – a large swath of the multilateral bundle of sanctions that were imposed on Iran, and on third parties dealing with Iran, in the wake of the 2009 disclosure of Iran’s secret nuclear facilities. “Implementation Day,” as JCPOA calls it, has arrived.

And what has been implemented is far more complex than the hostages-for-renewed-trade deal negotiated between September 1980 and the final hours of the Carter Administration.² Not “all” trade sanctions imposed by the U.S. on Iran are now lifted. Much now *is* changed, particularly for Asian and European companies that see Iran as a sophisticated untapped source of new opportunity. But even those companies must pause to be certain that remaining U.S. constraints on the use of the

“Much now is changed, particularly for Asian and European companies that see Iran as a sophisticated untapped source of new opportunity. But even those companies must pause to be certain that remaining U.S. constraints on the use of the U.S. banking system do not snag their Iran prospects by a back door.”



U.S. banking system do not snag their Iran prospects by a back door. And for U.S. companies, little has changed other than the important development that their foreign subsidiaries are now permitted to engage in dealings with Iran on a similar footing as their non-U.S. controlled foreign counterparts.³

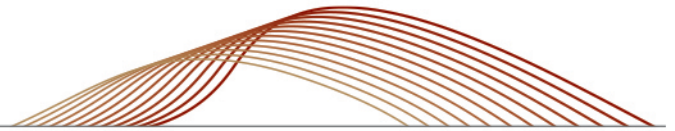
So what to make of Implementation Day?

What Iran has done

The place to begin is with what Iran has done – if the IAEA's verification is to be credited – to arrive at Implementation Day. JCPOA included a rather remarkable Annex I, in which, over 29 pages, Iran agreed to demonstrate to the IAEA that it has:

- Removed and filled with concrete the reactor core of the heavy water research reactor at Arak
- Inventoried and arranged for export of heavy water stocks, and opened its heavy water plant to IAEA monitoring
- Removed advanced centrifuges and infrastructure, and begun observation of a 3.67% ceiling on enrichment (well below the 90% enrichment required for nuclear weapons)
- Arranged to conduct R&D on advanced centrifuges under specified limits and subjected to IAEA monitoring
- Reconfigured the underground Fordow enrichment plant for use as a technology and collaboration center, with daily access by IAEA for monitoring
- Reached agreed templates and procedures for measuring and describing its civilian enrichment activity
- Transferred enriched uranium stockpiles out of Iran
- Ceased manufacturing baseline centrifuges, except as replacements for failed or damaged machines, and identified and opened for IAEA monitoring centrifuge component manufacturing capability
- Agreed to facility-specific arrangements by which IAEA can carry out transparency and monitoring activity
- Accepted the IAEA Additional Protocol that spells out state-of-the-art obligations for civil nuclear programs.

News accounts and official Iranian press releases reported last week that key steps – the destruction of the Arak reactor core, the shipment of enriched uranium stockpiles to Russia – have been carried out. Reports have been less specific about the dismantling of thousands of centrifuges that now exceed the agreed-upon numerical limit, and about the modes by which Iranian cooperation with IAEA monitoring has been, and will be, conducted.



The IAEA now has vouched that Iran has complied with the checklist. We profess no expertise in the technical aspects of nuclear proliferation containment regimes, but we do have a good sense of the politics and appearances of the moment for the IAEA and for the P5+1: after decades of tension over Iraqi and Iranian nuclear programs, the IAEA has low tolerance for the potential that it will be made a fool of; and after discovering that Iran had (despite its contrary representations) undertaken several years of undetected construction on the underground Fordow site before intelligence agencies unveiled it in 2009, the P5+1 (not to mention Israel) can be counted on to train the most advanced intelligence technologies and methods on Iran's conduct of nuclear activity, in order to confirm that Tehran's program remains peaceful only.

So for Iran's obligations under this agreement, the watchword is not the Reagan/Soviet-era "trust, but verify." There is little, if any, trust between Iran and any of the JCPOA signatories; even the Russians have direct, ongoing hostility with Iran over their proxies in Syria. Whether JPCOA's "verify, then monitor and verify again" regime will operate effectively is an unsettled question.

But it is the road we are now going down, and with it comes the flip side question – for clients, how does Implementation Day alter what their business units can do with respect to Iran? Here's how.

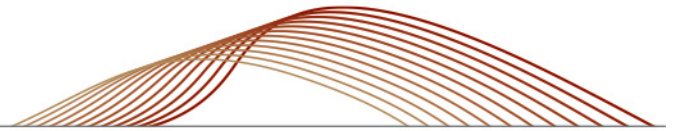
What sanctions the U.S. has lifted

Implementation Day triggered a series of regulatory modifications lined up by the Obama Administration during the period in which Iran was preparing its Annex I compliance steps. Those changes carry out the U.S. obligation to remove "all nuclear-related sanctions" specified in Annex II to JCPOA.

Such "nuclear-related sanctions" comprise a suite of expanded restrictions the U.S. imposed in 2010-2013 in the wake of the Fordow disclosures – including most prominently the restrictions on non-U.S. purchases of Iranian crude oil. But they do not include the fundamental prohibition against American companies dealing with Iran that pre-dates the recent round of nuclear sanctions. Nor do they include other sanctions imposed because of Iran's support of terrorism, human rights conduct, or ballistic missile program. And most important, the U.S. commitment under JCPOA is narrowed by a footnote that hangs directly off the "all nuclear-related sanctions" language:

The sanctions that the United States will cease to apply ... are those directed towards non-U.S. persons. ... U.S. persons and U.S.-owned or -controlled foreign entities will continue to be generally prohibited from conducting transactions of the type permitted pursuant to this JCPOA

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Take, for example, the auto industry. U.S. auto companies have long been prohibited from any dealings with Iran. For a period of time, their foreign subsidiaries had potential latitude to sell to the Iranian market provided that no U.S. person – the parent in Detroit, or any U.S. national assigned to the foreign subsidiary – participated in or facilitated the dealings, and the product involved contained minimal U.S.-origin content. As a practical matter, that meant virtually no U.S. auto dealings with Iran. Even that potential loophole was closed in 2012, when Congress expanded the sanctions regime to cover U.S. overseas subs.⁴

Asian and European auto companies were not precluded by similar restrictions, though the reputation risks of dealing with Iran kept their activities limited. In June 2013, however, as an additional measure to increase the squeeze to bring Iran to the negotiating table, President Obama extended U.S. sanctions to include sales by third-country manufacturers on items “used in connection with the automotive sector of Iran.”⁵

This action, intended to stun the Iranian side (which was thought to be using revenues from the auto sector to circumvent multilateral sanctions), stunned Japanese and European automakers more. But, pressed by this and other measures imposed in 2012-13 by the U.S. and the multilateral coalition, Iran agreed in November 2013 to a negotiated cease-fire – the Joint Plan of Action (“JPOA”), which formed the basis for the long negotiations in Lausanne and Vienna, and which granted Iran temporary suspension of the new “automotive sector” sanctions and other more recent measures.

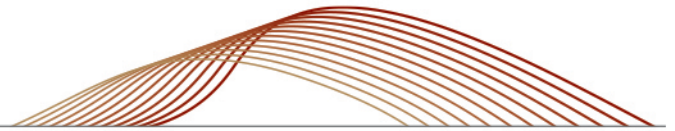
As a consequence of Implementation Day, the Obama executive order imposing the no-auto-sector-trade expansion is terminated. For Asian and European automakers, that puts the Iran market back in play. (But caveat: what does the IRGC have to do with carmaking in Iran? More below on this.) For U.S. automakers, though, Implementation Day is no news. They remain constrained by the underlying prohibition on U.S. person dealings with Iran.

Except in one way, which provides a way out for some.

A way out

Among the U.S. Implementation Day obligations under JCPOA is to “[l]icense non-U.S. entities that are owned and controlled by a U.S. person to engage in activities with Iran that are consistent with this JCPOA.”⁶ For decades, save for food, medicine and personal communications technology, the OFAC policy on Iran licenses has been denial – virtually no license request is approved, regardless of circumstances. In JPCOA, the White House pledged that post-Implementation Day, OFAC would license foreign subsidiaries to deal with Iran where the activities “are

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consistent with this JCPOA.”

What, the sanctions bar has been asking itself (and OFAC), does that mean? If the Middle Eastern subsidiary of a U.S. auto company proposes to supply new passenger cars to an Iranian distributor, would that be “consistent with” the Vienna agreement? What about spare parts for pre-embargo American cars still on the road in Iran, or cars that have found their way to Iran from other Middle Eastern countries? What about ambulances? Or radio and navigation equipment contained in them? The same questions would arise in civilian sectors from light bulbs to light rail.

We now have our answer. New Iran General License H authorizes “U.S.-owned or – controlled foreign entities”⁷ to engage in all transactions involving Iran on an equal footing with other foreign entities, provided that U.S. persons (including the U.S. parent, its management or any U.S. person located at the foreign entity level) are not engaged in or “facilitating” those transactions. And General License H includes an important narrowing of the notoriously-vague concept of “facilitation”: U.S. persons (including senior management and advisors) are now permitted to engage in the “establishment or alteration of operating policies and procedures of a United States entity or a U.S.-owned or -controlled foreign entity, to the extent necessary to allow a U.S.-owned or -controlled foreign entity to engage in” permitted transactions with Iran. In addition, General License H allows the foreign subsidiary to access automated “back office” support apparatus maintained by the parent, such as global email, accounting and resource planning software systems, even if for the purpose of conducting transactions with Iran.

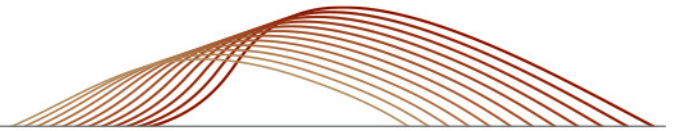
This is a noted change; under the pre-existing Iran sanctions regulations, U.S. persons engaged in an evasion or prohibited facilitation by, among other things, “[c]hanging the operating policies and procedures of a particular affiliate with the specific purpose of facilitating transactions that would be prohibited by this part if performed by a United States person or from the United States,”⁸ and practitioners have long warned clients off allowing even wholly-separate foreign subsidiaries to talk with Iran because of globally-integrated accounting and communications systems.

So where there was only a wall, there now is a door. Going through it will require care for U.S. companies that do not have the free-standing overseas manufacturing and decisionmaking process that large U.S. multinationals can adapt to these new rules. But now there is daylight and a doorway to explore.

What the U.S. has not lifted

Perhaps equally important is what is not changed.

For non-U.S. clients, as noted above, lifting of “secondary sanctions” – that is, removal of extension of U.S. sanctions to third-country nationals in a number of instances – will be useful. The shrinkage in the U.S. blacklist of persons with whom



U.S. nationals cannot deal (the Specially Designated Nationals, or SDN, list) also simplifies some areas of concern for non-U.S. clients.

Even as the SDN list contracts, however, important restrictions remain even for non-U.S. actors.

Perhaps most confounding for those who believe they have the green light to engage with Iran is how to avoid the far-reaching tentacles of the Iranian Revolutionary Guard Corps (“IRGC”). These are the same folks who treated the world to a broadcast of ten U.S. sailors, kneeling at gunpoint and being forced to apologize for the gross sin of allowing their two tiny patrol boats to drift slightly off-course in the Persian Gulf. (For any that doubt the impact of the JCPOA and the diplomatic shifts it has brought, ask yourself whether in previous years the captives would have been released in less than 24 hours; better yet, ask the Royal Navy, whose sailors were held for more than 13 days (and reportedly subjected to mistreatment) in a nearly-identical incident in 2007.)

The IRGC is much, much more than an elite unit of the military in Iran. It is a significant player in major segments of the Iranian economy, with ownership and management interests extending into such far-flung industries as construction, shipping and port operations and – notably – the automobile sector.

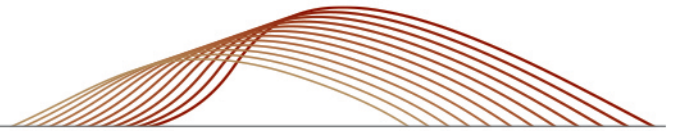
And therein lies the rub. A central feature of the U.S. secondary sanctions has been the expanding designation of industry sectors and entities determined to be controlled by the Republican Guard. A search of OFAC’s SDN List reveals more than two dozen entities with the “[IRGC]” tag, most of which will continue to be sanctions targets even after Implementation Day.

“Does the lifting of the executive order mean that the Administration has abandoned efforts to target those auto companies that may continue to have IRGC ties?”

This brings us, again, to the example of Iran’s automotive sector. The Obama Administration included restrictions on this sector in its 2013 executive order (something that Congress refused to do when passing the statute underlying that order) in response to assertions by the anti-Iran lobby that the key Iranian auto manufacturers have significant ties to the IRGC. Does the lifting of the executive order mean that the Administration has abandoned efforts to target those auto companies that may continue to have IRGC ties? Or will OFAC now apply the [IRGC] tag to specific companies, with the effect that non-U.S. companies will still be required to steer clear of dealings with those targets or face possible U.S. sanctions?

No U Turn

Still, the biggest question mark arises from the absence in JCPOA of any change in the U.S. restrictions on participation in dollar-denominated transactions in which Iran is involved.



In late 2008, Treasury closed off the dollar “U-turn” exemption by which U.S. banks were permitted to clear dollar-denominated transactions in which Iranian parties were involved. The U.S. has declined to reinstate this exemption as part of the JPCOA modifications. Thus, all transactions denominated in dollars – even if conducted by a non-U.S. company with a non-SDN-listed person or business in Iran – must pass through a U.S. clearing bank, and those banks continue to be precluded from participating in any transaction in which an Iranian national has an interest.

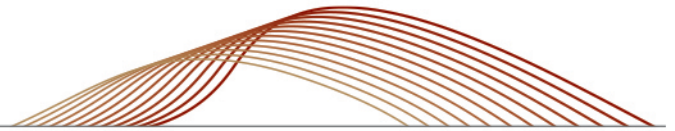
That means the hordes of French, German, Japanese, and other businesses that have descended on Tehran will often find their ability to do deals thwarted by the “no U turn” sign on the U.S. banking system. For some industries, notably the oil sector, access to dollar-denominated transactions is an essential structural requirement. For others, such as the industrial equipment or shipping sectors, transactions and funds flows may undergo rapid redesign as participants look for ways to carry out the entire process in euros, yen, or renminbi.

Put another way, the sanctions landscape for USD transactions with Iran will closely resemble the one that existed in 2009, after closure of the U-turn loophole and before the rise of secondary sanctions. There will be many non-U.S. players seeking to deal with Iran and looking for ways to finance those deals using the only currency that still occupies a preferred position in cross-border trade. And the rules on what is and is not permitted will remain shrouded in complexity.

This caustic brew was precisely what underlay the recent, recordbreaking indictments and settlements brought against major non-U.S. banks by U.S. prosecutors over the past several years. Our review of nine such enforcement actions spanning the last five years and accounting for over \$3 billion in announced settlements reveals that nearly without exception the transactions that gave rise to U.S. sanctions liability took place *prior* to 2010, an era before the imposition of any of the secondary sanctions programs that are now being lifted.

The message for advisors and compliance officers could not be more stark: the risks for violation of U.S. sanctions against Iran, even for (especially for?) non-U.S. parties, did not go away on Implementation Day. Indeed, with so many players now looking to pour into Iran, those risks may have just gotten much larger.

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The election(s)

All of this uncertainty and risk is amplified by the 2016 election season – and not just in the U.S. On February 26, Iran will conduct its most comprehensive elections in recent history. The Iranian executive team that negotiated the deal with the P5+1 hopes to use Implementation Day as a badge of progress that will enhance its authority within the Majlis, the parliament body. President Rouhani is standing for election to the Assembly of Experts, which will select the successor to Supreme Leader Khamenei.

Coming four days before the “SEC primary” in the U.S. – the date on which 13 states in the South and Midwest will vote on presidential candidates, the election results in Iran will be as closely watched in Washington as in Tehran. In an American election year that promises the most polarized and divided campaign in modern recollection, no issue will provide sharper contrasts between the eventual nominees than the “Iran deal”: however loud the rhetoric on immigration or the Obamacare health care reform, nowhere will there be a more clear “yes vs. no” posture than on the Iran engagement.

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For clients who are attempting to scope out their post-Implementation Day approach to Iran, this political uncertainty magnifies the legal risks. The consequences of a big Rouhani “win” in Iran are no more clear than the consequences of a renunciation at the Iranian polls of his rapprochement toward the P5+1.

What, then, to do? We spend much of our time in this field playing the cheerless role of lawyers: tamping down expectations, attempting to quantify risk to executives who do not want to be left behind as they see their counterparts in Europe or Asia streaming toward Khomeini Airport. It has never been a more interesting time to be a sanctions lawyer. But it also has never been more challenging.

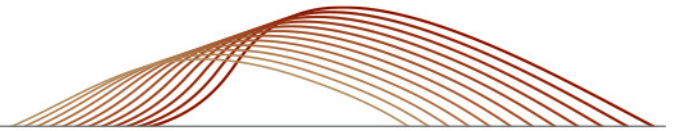
If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings Washington, D.C. lawyers:

Scott M. Flicker
1.202.551.1726
scottflicker@paulhastings.com

Hamilton Loeb
1.202.551.1711
hamiltonloeb@paulhastings.com

Paul Hastings LLP

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- ¹ That agreement, bearing the clunky moniker “Joint Comprehensive Plan of Action” (“JCPOA”), was signed by the foreign ministers of Iran and the 5 permanent members of the U.N. Security Council, plus Germany (the “P5+1”) and the European Commission’s top foreign affairs officer, on July 14, 2015.
- ² The Algiers Accords were signed on January 19, 1981, Carter’s last full day in office, but were not implemented until the next morning, the day Ronald Reagan was sworn in.
- ³ See Iran General License H (released January 16, 2016). Available at www.treasury.gov/resource-center/sanctions/Programs/Documents/iran_glh.pdf.
- ⁴ Iran and Syria Threat Reduction Act of 2012 (H.R. 1905) (“TRA”), sec. 218(b).
- ⁵ Ex. Order 13645, sec. 5 (June 3, 2013).
- ⁶ JCPOA Annex II, sec. 5.1.2. Section 5 also mandates authorization of the sale of U.S. commercial aircraft and parts, and importation of Iranian caviar, pistachios, and carpets.
- ⁷ A “U.S.-owned or –controlled foreign entity” includes an entity in which a U.S. person “(1) holds a 50 percent or greater equity interest by vote or value in the entity; (2) holds a majority of seats on the board of directors of the entity; or (3) otherwise controls the actions, policies, or personnel decisions of the entity.” General License H.
- ⁸ 31 C.F.R. § 560.417(c).