

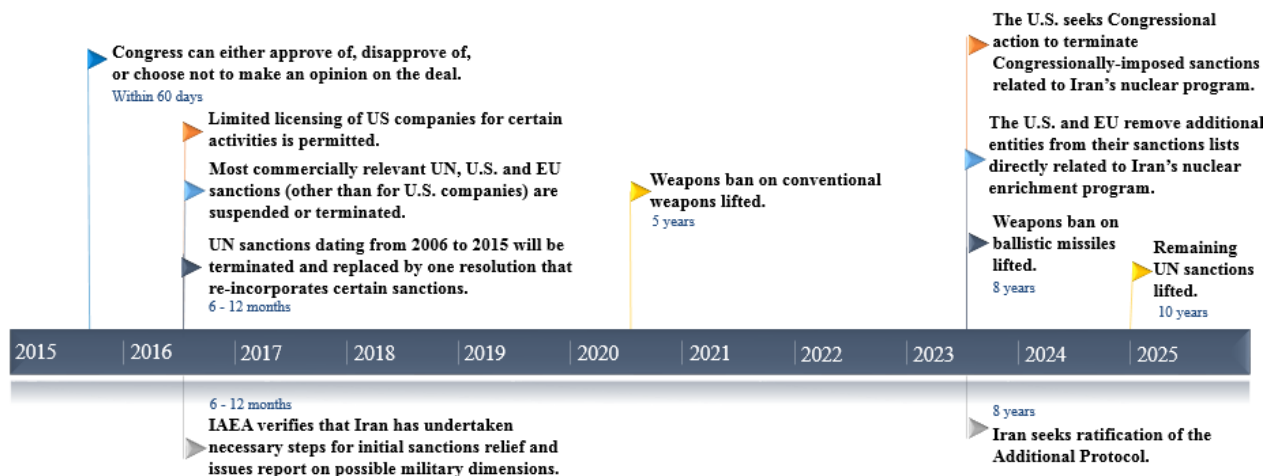


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Date: July 17, 2015

## Iran Nuclear Agreement

- The Joint Comprehensive Plan of Action (JCPOA) represents a major foreign policy achievement for the Obama Administration. A fierce, highly partisan, debate over its merits will consume much of Washington for at least the next two months, and could become a major issue of the 2016 campaign.
- Under the terms of the agreement, Iran will take steps to limit its uranium enrichment- and plutonium-related activities, and IAEA inspectors will be allowed to monitor Iran's activities, including through daily access by inspectors and the use of sophisticated technological methods that will give the agency immediate warning of a possible violation.
- Most commercially relevant UN, U.S. and EU sanctions (other than those for U.S. companies) will be suspended or terminated after the IAEA verifies Iran has undertaken its commitments as part of the deal – which will likely take 6-12 months. U.S. companies will also be given some relief at that point, including the ability of U.S. subsidiaries to receive licenses to engage in activities with Iran in areas consistent with the JCPOA – though it is unclear yet how broadly this will be interpreted. All of these sanctions can be snapped back or re-imposed in the event of Iranian non-compliance. In addition, sanctions related to Iran's human rights abuses and support for terrorism will remain.



- The U.S. Congress now has 60 days to review the deal, with a majority resolution of disapproval that would prevent the President from using his authority to waive sanctions a strong possibility. Obama has vowed to veto such a move, and it is unlikely Congress could muster 2/3 votes in both houses to override the veto, which would mean the agreement would go forward.
- While the deal seems likely to prevent Iran from acquiring nuclear weapons, it will require the United States to reinforce its commitment to Israel, Saudi Arabia, and other partners in the region.

## **Overview**

The P5+1 and Iran reached agreement on JCPOA on July 14, marking the culmination of almost two years of negotiations. The deal represents a major foreign policy achievement for the Obama Administration that, if fully implemented, could mitigate a major nuclear proliferation threat – and key source of tension in the Middle East -- for a decade or more.

As part of the deal, Iran will take a number of steps to limit its uranium enrichment-related and plutonium production activities with its actions phased over the next 8-15 years. These include certain limits on Iran's centrifuge research and development (R&D) activities for the first 8 years, a reduction of Iran's centrifuges by 2/3rds for 10 years, a 98% reduction of Iran's current stockpile of low-enriched uranium (LEU) and a pledge not to enrich new LEU over 3.67 percent for at least 15 years, and the conversion of the Arak heavy water research reactor and a ban on spent fuel reprocessing to reduce the proliferation risks.

These curbs address all the pathways Iran could take towards developing a nuclear weapon – using its uranium facilities, plutonium facilities, or covert methods.

These restrictions have not changed from the original framework agreement announced this spring, so the key sticking points in recent weeks revolved around two other issues: The first related to Iran's agreement to fully disclose its past work into possible nuclear weapons research to the IAEA, as outlined in the IAEA's report in November, 2011. Iran has now agreed to implement a "roadmap" by October 15 that will allow the IAEA to assess the possible military dimensions of Iran's past program and report its findings to the IAEA Board of Governors by December 15.

The issuance of the final report is necessary before any significant sanctions relief will be granted – meaning no sanctions other than those currently suspended under the interim agreement will be waived until then. It is unclear at this point how forthcoming Iran will be in this effort.

The second issue involved the level of inspections the IAEA will have in Iran to ensure it is living up to its commitments. Ultimately, Iran agreed to a presence of the IAEA in the country to monitor Iran's activities, to include use of sophisticated on-line enrichment measures and electronic seals that will give the agency warning of a possible violation.

If the IAEA or the members of the P5+1 believe Iran is not living up to its commitments or preventing the necessary access by the IAEA, any of them can refer the issue to a Joint Commission consisting of the P5+1, EU, and Iran, which would have 15 days to advise on how to resolve the issue. Notably, a resolution saying Iran is in violation would only take a majority of members (5 of 8) to implement -- meaning that Russia, China and Iran could not team up to veto such a move.

Should the Joint Commission fail to resolve issues (or if respective foreign ministers are unable to), either side would be allowed to refer the matter to the UN Security Council for re-imposition of sanctions which could not be blocked by Iran, Russia and China (more on that below).

### **Sanctions Relief and Timeline**

After submission of a report by the IAEA verifying that Iran has fulfilled its initial commitments under the deal, the P5+1 have agreed to suspend or terminate nuclear-related sanctions on the country. We expect the IAEA process to take 6-12 months – with the timeline somewhat dependent on how quickly Iran is willing to work with the IAEA. This means there will be no additional sanctions relief until at least the beginning of 2016.

The limited relief allowed under the interim Joint Plan of Action (JPOA) will remain in effect until that time.

In terms of process, there are three layers of sanctions relief for non-U.S. companies related to Iran's nuclear activities once the IAEA has verified Iran's activities:

- A series of UN sanctions dating from 2006 to 2015, which identify specific nuclear and proliferation-related violators in Iran and provide a framework and justification for national sanctions, will be terminated and replaced by one resolution that re-incorporates certain sanctions including those related to the procurement of proliferation-sensitive goods.
- U.S. sanctions on non-U.S. companies would be waived (in the case of Congressional sanctions) or terminated by the Obama Administration (in the case of executive orders).
- The EU will adopt a new regulation terminating all nuclear-related sanctions on its own companies.

At the same time, though the sanctions relief will not extend generally to U.S. companies, the deal includes three provisions that will make it easier for U.S. companies to work with Iran once the IAEA has verified completion of Iranian activities.

- First, imports of Iranian carpets and foodstuffs such as caviar and pistachios will once again be eligible to be imported into the United States, much as they were in the 2000s.

- Second, in addition to the provision of spare parts for airplanes that was permitted under the interim agreement, the United States will also allow for the sale of commercial aircraft to Iran. This will enable Iran to re-stock its aging fleet of airplanes – some of which are in dire straits, including from non-U.S. companies that utilize U.S. parts in their airplanes.
- Finally, foreign-incorporated subsidiaries of U.S. companies will be eligible for licenses to conduct activities “consistent with the JCPOA.” This provides some flexibility – albeit limited -- for U.S. companies wishing to do business in Iran. It is unclear how broadly this provision will be interpreted by the U.S. government, though we expect additional guidance to be forthcoming.

The second stage of relief will come eight years after the adoption of the new UN Security Council resolution, or possibly earlier if the IAEA concludes that Iran’s nuclear program is solely for peaceful purposes before that date. At this point the United States and EU will remove additional entities (people and companies) from their sanctions lists that are directly related to Iran’s nuclear enrichment program. The U.S. will also seek Congressional action to terminate Congressionally-imposed sanctions related to Iran’s nuclear program – though it is unclear how long these will actually take to come off as it would require Congress to pass new legislation. Sanctions related to Iran’s human rights abuses and support for terrorism will remain.

The third stage would come after ten years when the UN Security Council Resolution implemented as part of the JCPOA would be terminated.

Though these steps allow the P5+1 to maintain their pledge that sanctions relief will be phased over time, as we mentioned in our last report in reality most commercially relevant U.S., EU and UN sanctions (other than those for U.S. companies) will either be terminated or suspended in the first stage once the IAEA report comes out.

These include all trade sanctions targeting Iran’s oil sales and investment in Iran’s energy sector, provisions targeting Iran’s banking sector and access to the SWIFT network, a release of almost \$100 billion in Iranian money currently frozen abroad, and removal of a majority of Iranian individuals and entities from the Office of Foreign Assets Control’s (OFAC) Specially Designated and Blocked Persons (SDN) list and the EU’s own list.

Put together, this means that international (other than US) companies will face very few specific legal restrictions at that point in working with Iran – essentially bringing the situation back to what it was before 2010, when the United States began to impose a series of “secondary” sanctions on non-U.S. companies and the EU created an embargo for its companies.

### **A Note of Caution**

Despite having the legal authority to go back into Iran, we recommend that companies exercise caution in their approach to the country for a number of reasons:

- **First, a number of sanctions on Iran will remain.** These include sanctions by the U.S. and EU on Iranian individuals and companies involved in terrorism or human rights abuses. Companies should continue to make sure that they check their transactions against these names to ensure they do not run afoul of sanctions.
- **Second, all of the sanctions relief can be re-imposed if Iran does not comply.** This “snapback” is a key element of ensuring Iranian compliance over the longer term, but also creates uncertainty for the private sector. Notably, the JCPOA has a process for a Joint Commission to consider possible violations by Iran, which can then decide by consensus or by a majority of 5 of 8 members to refer Iran to the UN Security Council. This means that Russia, China and Iran could not team up to block such action. The Council would then have to vote to keep the relief in place – meaning that a single country (like the United States) could veto and cause all sanctions to be re-applied. U.S. and EU sanctions are also easy to put back in place, which would almost certainly happen in this scenario. The JCPOA does contain a clause noting that the re-imposition of the provision of the old UN sanctions would not apply retroactively to contracts signed prior to that date that were consistent with the JCPOA, though companies should seek clarity on the scope of this provision before committing to contracts.

This reality will make long-term planning difficult, with many companies hesitant to invest too much in Iran until they have a sense of whether the relief will last. This may be especially true for international financial institutions – traditionally very risk averse, which will be crucial for any real economic activity to happen.

At the same time, it is very much in the interest of the United States and its partners to see companies actually begin to trade with Iran, because that would presumably increase the incentive Iran has to live up to its side of the bargain. This may mean that the United States and EU may be willing to work with companies on what may be possible. The U.S. and EU will almost certainly approach the question of trade with Iran differently than before the deal.

Ultimately, companies should be cautious in their approach and seek both legal and policy advice before undertaking any activities in Iran.

- **Third, Iran suffers from years of economic mismanagement and has been virtually cut off from routine trade for the last few years.** Sanctions aside, Iran has suffered from high inflation and negative growth in recent years – even before sanctions were ramped up. It also has an expensive subsidy program that has gobbled up much of its oil revenues. Though the ability to again export oil and gas will help, reforms in this area as well as in the areas of privatization and its energy sector will be critical for Iran to return to growth. Meanwhile, Iran may be hesitant to fully embrace Western companies in the country and will want to closely manage the process. All this means that even though most sanctions will soon be relaxed, companies should expect a fairly difficult business environment.

## **Congress**

Now that the deal is completed, the Obama administration will need to sell it to the U.S. Congress, which has 60 days to review it, under the terms of the compromise legislation passed in May. After that point Congress can either approve of, disapprove of, or choose to not offer an opinion on the deal. If Congress chooses to disapprove the deal, the Obama administration would not be allowed to waive the Congressional sanctions that make up the bulk of the contemplated sanctions relief, though Obama has already indicated that he would veto such a move.

There is a good chance Congress can garner the support needed to disapprove the bill. It will be more difficult at this point for it to be able to sustain a 2/3 majority in both houses to override a veto by Obama, however. Nevertheless, the Administration is taking no chances, and we expect a full court press in the coming weeks to try to affect the outcome.

Were Congress somehow able to override a presidential veto, it is doubtful that the U.S. would be able to convince its allies to once again go along with sanctions on Iran despite a deal being in place. Ultimately, sanctions are most effective when multilateral, with the success of the current sanctions on Iran (vs. earlier unilateral U.S. sanctions) a case in point. Without this coalition the sanctions would inevitably be less effective, while at the same time Iran could rush to expand its nuclear program, given that the U.S. would not be upholding its part of the deal.

## **Regional Implications**

For its part, the United States will need to continue to reassure Israel, Saudi Arabia, and others in the region that it remains committed to their security, and that it has no intention of walking away now that the nuclear deal with Iran is done. In fact, the U.S. will likely find ways to increase its support to partners in the region, ranging from increased security assistance to Israel to release of advanced weapons to Arab Gulf states. President Obama began this effort at the Camp David summit in May, but it will require continuous effort and dedication on the part of the Administration. As a next step, Obama plans to send Defense Secretary Carter to Israel, and likely additional countries in the region, the week of July 20.

This reassurance will be especially important given widespread regional concerns that Iran will use some part of the almost \$100 billion of its assets that will be unfrozen to support its proxies around the region. Hizballah Secretary-General Hassan Nasrallah, for example, was quoted recently expressing confidence that a nuclear deal would enable Iran to increase support to Hizballah and Palestinian terrorist groups significantly. Whether or not these fears are realized, and there is reason to argue both perspectives, the Administration will need to address this issue to show that it is responding to the concerns of its regional partners.

Finally, even with the nuclear agreement completed the U.S. continues to face a range of challenges in the region, most notably the fight against ISIS. In this the United States and Iran face a common enemy, where working together – or at least not at odds – they could be more effective. At the same time, however, U.S.-Iranian cooperation on regional issues such as the

fight against ISIS could make it more difficult to enlist the support of Iraqi and Syrian Sunnis as well as regional Sunni states. The U.S. will therefore need to carefully balance its various interests as it explores the possibility of a new relationship with Iran while at the same time trying to reassure Israel and the Gulf Arabs that it will continue to ensure their security.

### **Moving Forward**

Like any international agreement of this complexity, some complications such as disputes over implementation as inspectors move into position, political arguments among the parties about the pace of implementation and sanctions relief, and likely even charges of cheating -- possibly fueled by anonymous leaks -- are possible. Through the fall, either Iran or the P5+1 may even accuse the other side of bad faith in one area or another, and it is possible one side could proclaim a temporary suspension to implementing one or another part of the agreement. In such a scenario Ministers would be convened, emergency meetings would take place, and deadlines would be announced.

This cycle is, for a deal of this magnitude, normal, and we expect that each side is already looking at the timeline in order to see when problems may arise, and when it might be advantageous to potentially provoke a dispute so that the air can be cleared. In this environment, any announcements that the agreement is dead or dying will be repeated but will be exaggerated. The fundamentals of this deal are solid, which provides incentives for both sides to comply.

There will also be fierce debates in Washington, Tehran and elsewhere in the coming months as supporters and critics of the deal -- as well as those who would use it as a political issue -- attempt to frame the debate to their advantage. The process will continue even after implementation as both sides closely watch for any indications of failure or success -- with a strong likelihood this will become a major issue in the 2016 U.S. presidential campaign.