The carrot and the stick

Snapback provisions in this year's nuclear deal are not subject to grandfathering. That creates real risks for foreign investors

The nuclear deal struck between Iran and global powers in July this year has caught the attention of many businesses looking to enter the Middle East's second largest economy, once it is legal to do so. However, they must carefully weigh the risk of sanctions potentially destroying their investments. It's possible that the sanctions could snapback once lifted; and the agreement contains no grandfathering clause.

Many US and EU sanctions that restrict business in Iran's financial and energy sectors will be lifted when the International Atomic Energy Agency issues a report confirming that Iran has met its nuclear commitments under the deal. This is likely to take place in the next few months, on what is to be known as implementation day.

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However, the nuclear agreement contains a mechanism that permits sanctions to be reinstated during the course of the next 10 years if Iran engages in behaviour that another participant to the deal believes amounts to 'significant non-performance' of its obligations. This can occur only after the prescribed dispute resolution procedure has been followed.

The concept of snapback, as it has come to be known, therefore looks like a weighty stick over Iran to accompany the carrot of western investment. At its most basic level, the threat behind snapback is: adhere to the terms of the deal, or once again be starved of international capital.

Businesses may, however, not wish to invest in the droves that have been anticipated. Some may consider it too risky. This is because the deal does not protect activities if sanctions prohibiting them are reinstated. That's the case even if those activities are conducted pursuant to contracts signed during a period when sanctions had been lifted.

On this point there are, however, views to the contrary. There is significant support in published literature for the idea that contracts under the nuclear deal are grandfathered. According to this perspective it would be permitted, for example, for a US or European business to enter into a long-term energy contract with the Iranian government once it is legal to do so, and continue to perform obligations under the contract even if sanctions snapback into place at a later date.

This view is, however, quite wrong. Performance under such contracts would be a criminal offence in the US and EU if the contract would be prohibited by sanctions which are reinstated. The White House has stated this point unequivocally in its guidance on the nuclear deal: *'there is no grandfathering clause…if snapback does occur, there are no exemptions from our sanctions for long-term contracts".* In contrast to the position in the US, there is a notable lack of European guidance on the nuclear deal. However, White House guidance arguably offers a clear view for Europeans also: participant states should have the same understanding of provisions which apply equally to all participants.

The ambiguity arises as a result of paragraph 37 of the nuclear deal, which provides that:

> *'[if sanctions are re-imposed, relevant prohibitions] would not apply with retroactive effect to contracts signed between any party and Iran or Iranian individuals and entities prior to the date of application [of the re-imposed prohibitions]'*

Similar language is repeated in the Security Council resolution adopting the nuclear deal. It is possible that the draftspeople, not necessarily having legislative drafting expertise, may not have fully understood how the particular words which were used might be interpreted. Many people look at this wording and understand it to mean that there is grandfathering.

However, all this paragraph does is make clear a basic rule of law point: that nobody can be punished for an act which was legal at the time it was carried out. Indeed, saying it carries little interpretative benefit and has led to confusion.

Grandfathering of contracts carries this basic, rule of law concept much further. It protects activities entered into legally – even though they would, at a later date, be illegal – for any time after it becomes illegal to conduct such activities. There are examples of contracts being grandfathered into new sanctions rules. Most notably, in 2010 when the US exempted the North Sea Rhum oil field project, owned by BP and the National Iranian Oil Company, from new US sanctions on Iran. However, such cases are an aberration from normal practice and are invariably a response to very specific policy concerns. Grandfathering under sanctions law has never extended to an unknown and indeterminate range of contracts in relation to a great number of possible areas of commerce. This remains the case following the Iran nuclear deal.

For businesses, therefore, investments could be wasted, possibly resulting in total loss. This is particularly a concern for large-scale, difficult-to-move and expensive investments that are now being contemplated by energy companies. US and EU sanctions implemented in the past, typically by a quick process that leaves little time to react, have led to investment losses in countries such as Sudan, Myanmar, Syria, Iraq and also Iran. There may be a grace period, as has been allowed in certain instances whereby US and EU sanctions authorities permit the wind-down of investments over time rather than immediately criminalise all activities pursuant to contracts in newly-sanctioned countries. Nevertheless, such concessions involve investment loss.

The snapback process

Snapback is far from a quick or snappy process. Two months are needed to reinstate sanctions, and the process could take even longer if extensions are used by the various committees and advisory boards that are responsible for opining in response to a complaint.

The snapback process is as follows.

A participant to the deal complains to the UN Security Council that another participant has not performed its commitments under the deal. There are no prescribed grounds for snapback. This permits a large amount of subjectivity on the part of a complainant as to whether an act constitutes significant, non-performance of obligations under the deal. The process is almost certainly intended to address the possibility of the US complaining about Iran, but could also include the UK, Germany, France, or Iran as complainants against any other participant state.

A number of stages follow in which a joint commission and advisory board provide opinions on the matter. The joint commission, composed of representatives of each participant state to the deal, would look at the matter and within 15 days would issue its opinion on how it should be resolved. The time period may be extended by consensus of the joint commission. If the complainant feels that the issue has not been resolved, it can take the matter to the foreign ministers of the participant states. The ministers have 15 days to resolve the complaint, but can agree to extend the timeframe by consensus. At the request of the complainant or the complained-about state, the matter is then delivered to an advisory board composed of one member appointed by the US, one by Iran and a third 'independent' member. They issue a non-binding opinion, which must be delivered within 15 days. If the matter is not resolved, the joint commission has five days to consider the board's opinion. This takes the process to at least 35 days, and up to 50 days with all of the extensions.

There is no guarantee that the various consultations and opinions in these stages would resolve the complaint. If the complainant holds to its view that Iran has engaged in actions that constitute 'significant non-performance' of its obligations, the complainant may stop complying with its commitments under the deal, refer the matter to the Security Council, or both.

The Security Council may then vote on a resolution, ostensibly to be conducted in accordance with normal Security Council voting procedures. Critically, the resolution is not to restore sanctions, but instead 'to continue the sanctions lifting'. So the veto right is flipped around from its usual construction. The complainant, even acting alone, has the power to veto any attempt to maintain sanctions. Effectively, no participant state can block the reinstatement of sanctions at the initiative of another participant state, which disrupts the usual way of doing things in the UN Security Council. There is no precedent for a Security Council disenfranchising future Security Councils who may wish to veto a proposal on the basis of the intentions of a single Security Council member.

Finally, if the Security Council resolution is not adopted within 30 days of the complaint's referral, then provisions of the old Security Council resolutions would be reinstated. Confusingly, this is subject to the caveat of 'unless the Security Council decides otherwise'. The deal does not set out in any detail what this exception might mean. However its wording suggests that, as a practical matter, reinstating sanctions could be more complex than the short, albeit dense, paragraph on dispute resolution might suggest.

Preparing for the worst

The main comfort for businesses is that snapback is very unlikely to be employed. It would require Iran to do something so serious as to suggest it wished to be free of the deal in any case. An example of such a violation would be an increase of the country's uranium stockpile beyond agreed limitations, which would trigger concerns that it is only doing so to develop a nuclear weapon.

If sanctions are snapped back, Iran would immediately walk away from the deal. Indeed, it explicitly makes clear that its government may do so. Iran would, at this point, have had the benefit of many billions of dollars of assets being unfrozen on implementation day (estimates range from $50 billion to $150 billion), and would no longer be restricted under the deal in relation to nuclear activities. Further, sanctions do not work very well unless they comprise co-ordinated efforts between major powers. Imposing new sanctions alone is likely to have very little coercive effect over a target, particularly one that is a major regional economy such as Iran.

Businesses should consider how to deal with sanctions snapping back in contracts signed with Iranians after implementation day to ensure that, among other things, winding down or exiting Iranian business does not breach contractual arrangements. On this issue, the US Office of Foreign Assets Control has advised US businesses that contract with Iranians include provisions to terminate in full in the event that sanctions are snapped back. European businesses may also wish to consider doing this to enhance their contractual certainty.

Arguably, however, agreeing such terms could be unrealistic. Iranian counterparties may be unwilling to accept the re-imposition of sanctions as a specific termination event in a contract, as they may have little control over the snapback decision. Iranians may therefore also wish to ensure that snapback does not fall within boilerplate *force majeure* provisions in contracts. As such, US and European businesses may wish to consider, in practical terms and with detailed strategies, how they would wind-down or exit any Iranian business in the worst-case scenario, given that the nuclear deal offers no grandfathering.

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