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Doing Business in Iran: New Challenges and Opportunities

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"Opportunities will abound for investors willing to enter Iran, and it would be senseless to avoid considering Iran altogether for fear of sanctions and compliance risk."

Nicholas Borroz
TD International

"The signing of the deal marks Iran's official return to the international stage."

West Sands Advisory

"Doing business in or with Iran will continue to be a highly politicized and sensitive issue for companies with ongoing business in the U.S."

Control Risks

"Over-eager investors that fail to exercise care, plan carefully, and undertake crucial due diligence before entering into the Iranian market may find themselves badly burned by the experience."

Art Keller
Iran Analysis Group

"The Iran nuclear deal will likely be the most controversial foreign policy issue of the 2016 general election campaign for the President of the United States."

Matthew Kroenig
Associate Professor
Georgetown University

As certain sanctions on Iran are pulled back, Western companies are carefully considering the prospect of navigating Iran's business environment, complying with remaining sanctions, and assessing the country's future relationship with the world. To help businesses better understand the opportunities and pitfalls of operating in Iran, RANE has curated commentary produced by expert firms Debevoise & Plimpton, West Sands Advisory, and Control Risks; experts Matthew Kroenig, Art Keller, and Nicholas Borroz; and other Iran specialists.

BACKGROUND

On January 16, 2016, the Joint Comprehensive Plan of Action (JCPOA) went into effect, lifting some US and European sanctions against the Islamic Republic of Iran in recognition of compliance with a landmark international deal aimed at preventing the country from developing nuclear weapons. Recent parliamentary election results in Iran suggest that the country's population, which backed reform candidates by large numbers, is ready for change and tired of the conservative regime.

Iran boasts 77 million people, an educated workforce, developed manufacturing industry, strong investments in science and technology, and, according to a variety of sources, a population eager to be reintegrated into Western culture and markets.

However, because sanctions against the country have existed in some form since the 1979 Iranian Revolution, Iran's economy has developed in isolation from the global system and is uncharted territory for most Western companies. Some sanctions still in effect put significant restrictions on U.S. businesses operating in Iran, and there also remains the possibility that a political shift in the United States or Iran could result in the reimplementation of full sanctions.

Compared to their EU counterparts, U.S. entities are currently disadvantaged with respect to their freedom to invest in Iran. And while there are still opportunities for U.S. companies and individuals to make some moves into the market, they must tread very carefully in doing so.

THE END OF (SOME) SANCTIONS

The lifting of sanctions is expected to immediately benefit Iran's economy. Still, the implementation of the JCPOA has created differing economic opportunities for Iranian, European, and American companies. Iran will now be able to access long frozen funds abroad, and products, services, and technology that its economy sorely needs, and European companies will be able to provide these products. American companies, however, are still subject to a number of restrictions that limit their interaction with Iran.

- A number of Iranian entities have been removed from the EU asset freeze list, giving those entities access to funds abroad, according to Debevoise & Plimpton. Such entities include many of the major state-owned oil and gas companies, banks, and shipping companies.

- According to Art Keller, Iran is expected to benefit immediately from being able to: ship oil into international markets; accept foreign investments in its aging oil industry; access financial products such as shipping insurance; make deals on shipping, shipbuilding, and access to international ports; import precious metals; import replacement aircraft parts for civil aviation; and import machinery and software to update its automobile industry.

The majority of civilian trade and finance-related restrictions imposed by the European Union's nuclear-related Iran sanctions program have been lifted, according to Debevoise & Plimpton.

- Keller notes that Switzerland (which is not part of the EU) made moves to initiate trade with Iran even before Implementation Day, giving Swiss companies a head start. Swiss companies will benefit from selling precious metals, engaging in shipping, insurance, and oil and petrochemical related transactions.

- Certain restrictions remain, Keller notes. Europeans investing in Iran's oil sector, purchasing Iranian oil, and selling certain goods and financial products into the country must be able to demonstrate that the transactions do not benefit Iran's military or support for terrorism, a potentially heavy burden to meet in a country where certain elements of the military (most notably the Iranian Revolutionary Guard Corps (IRGC)) have sizeable holdings in numerous industries. Weapons and ballistic missile technology will remain barred for sale for eight years.

- Until recently, non-U.S. companies that conducted transactions with Iran outside the United States were prohibited from engaging with U.S. business, including with the financial and banking system, according to Debevoise & Plimpton. The United States has now lifted most of those secondary sanctions, except for transactions involving Iranian entities on the Specially Designated Nationals (SDN) list, which contains names of Iranian individuals and organizations that are off limits for Western companies. Most entities related to Iran's nuclear program have been purged from the SDN list. Entities associated with terrorism, missile technology proliferation, and the Revolutionary Guard remain.

However, the most restrictive primary sanctions remain, meaning U.S. companies and persons still face heavy restrictions on operating in or dealing with Iran.

- Keller explains that U.S. entities, including individuals and companies owned or controlled by U.S. citizens, are prohibited from conducting transactions with Iran "unless authorized to do so by the U.S. Department of Treasury's Office of Foreign Asset Control (OFAC)."

- The OFAC will provide General License H to some non-U.S. subsidiaries owned or controlled by U.S. companies wishing to engage with Iranian entities if the activities in which they wish to engage are consistent with the JCPOA and a firewall is established between the U.S. entities/persons and their Iranian subsidiary.

    - Robert Hormats notes that a General License H is broadly and vaguely constructed, and it is still not clear just how separate the Iranian subsidiaries will have to be from the parent in practice.

    - Even with General License H, Debevoise & Plimpton notes, approved subsidiaries still face major restrictions on their business in Iran. They may not export, sell, or supply any goods, services, or technology of U.S. origin to Iran. They may not engage in transactions with the Iranian military, police, or individuals on the SDN list. And even for legal transactions that include goods or services sourced from outside the U.S., the subsidiaries may not engage the U.S. banking or finance system,

    - Debevoise & Plimpton adds that U.S. persons are forbidden from controlling Iranian subsidiaries of U.S. companies. Those subsidiaries may, however, access their parent company's "automated and globally integrated" support systems, such as email, allowing them to benefit from the company's global infrastructure. In short, a significant divide will have to be established between U.S. and Iran operations, requiring them to operate in many respects as wholly separate entities.

GETTING TO KNOW IRAN

Iran's economy has suffered in recent years, largely because of sanctions and the low price of the oil on which its finances rely, but it is well positioned to take advantage of the openings the JCPOA offers.

- In addition to oil and gas, Hormats describes the Iranian economy as featuring a highly developed services sector, tourism, good telecommunications infrastructure, automobile and bus manufacturing, a pharmaceutical industry, and steel and other metal production.

- Iran's economy boasts several features that will be attractive to international investors. Hormats identifies a young, highly educated workforce with skills in mathematics, science, information technology, engineering, and medicine, and a general population with a strong desire to end isolation, and a tendency toward entrepreneurialism.

- West Sands highlights the wealth of natural resources in Iran and the country's strong investment in science. "The country is one of the Middle East's largest investors in scientific research," they note. "Iran's engineering and medical research institutes are among the best worldwide, especially in the high-tech industry and stem cell research."

However, the Iranian economy does have weaknesses, and isolation from the global environment has created transparency and corporate governance issues.

- Even with optimism about the nuclear deal, Iran's economic growth slowed in 2015. West Sands Advisory reports that the drop of global oil prices hurt the country, both private and government investment has dropped, and economic stagnation has forced thousands of factories to close. However, the IMF predicts a rebound of 5.5 percent growth in 2016-2017.

- Hormats notes a litany of problem areas: high inflation, high unemployment, instability caused by low oil prices, the mismanagement of large government-controlled oil companies, little transparency across all sections of the economy, corruption, bureaucratic obstacles to doing business, and a need for modernization in financial and business regulations and corporate governance due to isolation from the global economy.

- West Sands Advisory adds that major structural reforms will be needed in order to increase bureaucratic and financial transparency.

The Iranian government and government-affiliated organizations control significant stakes in major sectors of the economy. Companies wishing to do business in those sectors run the risk of running afoul of Western sanctions by partnering with the wrong individual or organization, or of bureaucratic obstacles that aim to help protect those domestic organizations. However, there are economic opportunities for those willing to navigate those risks.

- Iran's theocratic national government holds controlling interest over major parts of the national economy. This is especially true in the oil, gas, and petrochemical sector, the products of which comprise 78 percent of Iran's exports. Keller estimates that, between the petrochemical industry and state-run economic conglomerates, the government controls 90 percent of Iran's economy.

- International investors operating in Iran are advised to be aware of nominally charitable organizations called *bonyads* that control significant for-profit holdings across a range of sectors in the Iranian economy. These tax-exempt organizations are controlled by clerics who answer to the Supreme Leader and hold significant economic assets. Hormats describes them as reluctant to disclose political relationships, show transparency in bookkeeping, or give any decision-making power to foreign partners. Keller notes that businessmen have complained about *bonyads* using political connections to create bureaucratic obstacles for competing international firms.

- The Iranian government's control of the economy does allow it to direct investment priorities. Citing senior Iranian officials, Hormats advises that the main targets for foreign investment are mining, energy, automotive production, steel manufacturing, and technology. "Iranian officials emphasize to foreigners," he adds, "that investment will not only enable companies to sell to the Iranian population, but also to use Iran as an economic 'gateway' to Central Asia."

- Arrests of foreigners by the Iranian government, nominally over intelligence activities, have occurred in the past. However, several Americans were recently released, and improvements in the relationship between Iran and the West may bring an end to (or at least limit) the practice. Keller believes that the threat of violence and kidnap attempts against foreign businessmen is extremely low, and there is a lack of the "terrifying fusion of state security agencies melded with untouchable organized crime groups" that threaten foreign businesses and individuals in Russia. Even the IRGC, which controls significant economic holdings, typically fights competition only by creating bureaucratic hurdles.

THE FUTURE OF THE DEAL

The JCPOA is structured to reward good behavior by Iran over time, and positive relations between Iran and the United States could result in more sanctions being lifted. However, support for the JCPOA in the United States is a political issue, and a number of factors – including a change in leadership following the 2016 presidential and Congressional elections – could result in the deal being repealed.

- According to the JCPOA, if the International Atomic Energy Agency reports after eight years that all Iranian nuclear activity is peaceful, the United States will permanently terminate its secondary sanctions and remove additional persons from the SDN list.

- Keller points out that the JCPOA provides Iran with access to international goods and services without allowing Americans to supply them. Behind-the-scenes pressure from economic interests may induce politicians to repeal additional sanctions, allowing U.S. businesses the same access to the Iranian market that European businesses enjoy.

- Opponents of the JCPOA fear that the deal will fail to prevent Iran from becoming a nuclear weapons power. Matthew Kroenig of Georgetown University believes that the deal will allow Iran to benefit from sanctions relief while safely developing its nuclear enrichment program to the point where the country can quickly produce nuclear weapons, and thus does not adequately protect the United States. Arguing that only economic pressure will force Iran to abandon its nuclear weapons program, he says, "As the economic pressure builds again, Iran's leaders will return to the negotiating table looking for relief. And they will know that in order to receive it, they must take one simple step: dismantle their sensitive nuclear infrastructure."

Iran's willingness to cooperate with the West and follow the terms of the JCPOA, as well as its ability to reform its economy, will likely depend on the balance of power between the conservative old guard and President Hassan Rouhani's relative moderates.

- Iran's February 27 elections were a victory for a coalition of reformists and moderates. Rouhani's moderates now control a significant portion of the Parliament and a "decisive majority" in the Assembly of Experts, the body tasked with electing the next Supreme Leader.

- Georgetown University's Daniel Brumberg believes that the results of the election demonstrate incremental reform rather than a genuine democratic revolution, but reveal the population's desire for change and the hardliners' admission that they can no longer marginalize reformers. "The decade-long and relentless effort of hardliners to exclude all voices other than their own has been decisively blocked," he notes, "and perhaps even reversed."

- Though the Supreme Leader ultimately holds power in Iran, West Sands notes that the current Leader – Ayatollah Ali Khamenei – is aging and not in good health. His successor will be chosen following his death, likely by the newly elected Assembly of Experts.

RECOMMENDATIONS FOR BUSINESSES OPERATING IN IRAN

Economic connections are often built through personal relationships in Iran. However, businesses should practice enhanced due diligence to ensure business partnerships don't result in more harm than good.

- Keller emphasizes the importance of cultural expertise in doing business in Iran. For example, interested parties must not conflate Iran, a Persian culture, with the Arabian cultures of the Middle East.

- "Iran's economy is very much relationship-driven," says Keller, "and having the right connections is disproportionally important for business success in Iran." Due diligence is critical, as choosing the right partner could be the difference between making a business deal and ruining it.

- Because international standards such as Generally Accepted Accounting Practices are not part of Iranian business culture, international investors in Iran will find identifying good business partners challenging.

- Economic partnerships with *bonyads* or other government-affiliated groups offer both benefits and pitfalls for Western companies. Those organizations are well-positioned in the Iranian economy and their support will give a Western company a significant advantage in establishing itself in Iranian markets. However, their government connections will give them a strong advantage over foreign companies should an internal dispute arise.

- Nicholas Borroz identifies a general lack of transparency concerning true ownership in Iranian companies and points out that these companies, knowing the compliance and reputational risks that IRGC or other connections pose for Western companies, will likely try to hide such links. He recommends that potential investors work with sanctions experts in addition to conducting due diligence investigations that should include researching and cross-referencing potential Iranian individuals against sanctions lists. Borroz also suggests performing "investigations that are based on discreet in-country inquiries, as well as broader social and political monitoring projects."

- Due to isolation from the global economy, international compliance requirements and corporate governance standards are not common to Iranian companies. Control Risks advises that companies embed these standards from the first day on when doing business in Iran.

- Government-run organizations can influence the bodies that regulate key sectors of the market, Control Risks notes. Companies should understand the key stakeholders in their sector and be able to predict regulatory changes.

Companies investing in Iran should also be aware that, despite the implementation of the JCPOA, Iran's position in the world economy is still tenuous and prepare for the possibility of renewed sanctions and reputational risk.

- Investors should beware of potential snapback of the JCPOA, if Iran violates the deal, or a repeal of the deal should there be a political reversal in either the United States or Iran. Other sanctions unrelated to the JCPOA could also disrupt business in Iran, Hormats notes. For example, Iran may incur sanctions for violating UN Security Council resolutions regarding missile tests, as many politicians in the U.S. have already called for. Control Risks advises companies "map the different scenarios for the implementation of the JCPOA, monitor those scenarios' triggers, and structure their contracts and business to account for that threat."

- Control Risks emphasizes that, because Iran is a politicized and sensitive issue both in the United States and around the Middle East, companies operating in the country run reputational risks. Saudi Arabia in particular has indicated its intent to limit trade with Iran. Companies should practice proactive partner identification to avoid aggravating this risk, and multinational companies should identify in what regions association with Iran could negatively affect them.

ABOUT THE EXPERTS

Debevoise & Plimpton LLP *is a premier law firm with market-leading practices, a global perspective and strong New York roots. Its clients look to it to bring a distinctively high degree of quality, intensity and creativity to resolve legal challenges effectively and cost efficiently.*
Read: Implementation Day – Iran Sanctions Relief Now Effective

West Sands *is a UK-based advisory firm that uses human-sourced intelligence and seasoned analysis to help our clients create opportunities, reduce risk and solve problems in opaque and difficult environments.*
Read: Iran Outlook 2016

Control Risks *is an independent, global risk consultancy specializing in helping organizations manage political, integrity and security risks in complex and hostile environments.*
Read: Iran market risks will remain despite implementation of JCPOA

Matthew Kroenig *is an Associate Professor and International Relations Field Chair in the Department of Government and School of Foreign Service at Georgetown University and a Senior Fellow in the Brent Scowcroft Center on International Security at The Atlantic Council.*
Read: How to Unwind the Iran Nuclear Deal

Iran Analysis Group founder ***Art Keller*** *served in the US Army during Operation Desert Storm and later spent seven years serving in the Central Intelligence Agency's Directorate of Operations, where he worked on cases to block the proliferation of Weapons of Mass Destruction, with a particular focus on Iran.*
Read: Doing Business with Iran

Robert Hormats *is the Former Undersecretary of State for Economic Growth, Energy, and the Environment and current Vice Chairman of Kissinger Associates.*
Read: Post-Sanctions Economic Opportunities and Risks in Iran

Nicholas Borroz *is an Associate at TD International, specializing in geopolitical risk issues and energy-related infrastructure.*
Read: Beyond Sanctions: Minimizing Beneficial Ownership Risk in Iran

Daniel Brumberg *is Director of Democracy and Governance Studies at Georgetown University and a Non-Resident Senior Fellow at the Project on Middle East Democracy (POMED).*
Read: Iran's Zombie Democracy Comes Back to Life

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RANE is an information services and advisory company serving the market for global enterprise risk management. We provide access to, collaboration with, and unique insights from the largest global network of credentialed risk experts covering over 200 categories of risk. Through our collective insight, we help enterprises anticipate emerging threats and manage today's most complex risks more effectively.