

Special Briefing

The Realities of the Iran Nuclear Deal

July 16, 2015

After months of gruelling closed-session negotiations, a comprehensive agreement to limit Iran's nuclear capabilities was finally announced in Vienna on the morning of 14 July 2015. The 159-page deal, struck between the P5+1 (China, France, Russia, United Kingdom, United States and Germany) and Iran, was greeted with euphoria on the streets and social media platforms across Iran. Hassan Rouhani, the Iranian President, declared in a televised address that "the prayers of our nation have been answered and we now stand at a historic juncture". For his part, US President Barack Obama described the deal a step towards a "safer and more secure world".

Beyond the immediate media interpretation of the agreement, what does this mean for corporates with current or future interests in the region? Charles Hollis and Jackson Dunn of FTI Consulting take a look at some of the initial effects of the deal.

FTI'S VIEW ON THE IRAN NUCLEAR DEAL:

- Despite a deal being agreed, economic sanctions could be in place for another 18 months
- The pressure is now on Rouhani to deliver the benefits of a deal to an expectant Iranian population
- The agreement will remain subject to the domestic agendas of both Iranian moderates and hardliners
- If the deal holds, Iran, and its need for infrastructure investment, offers significant potential for multinational corporations (MNCs) that have a clear understanding of the market

A \$400 BILLION MARKET FOR GLOBAL BUSINESS?

Many global executives are actively considering investment in Iran following news of the deal. It's not difficult to understand why. Iran is a country of more than 80 million people with 60 percent of the population under 30 years old. From a consumer perspective, it is a country that has a strong affinity to Western brands, particularly US brands. The country's \$100 billion Tehran Stock Exchange offers some of the most undervalued

investments in a market that does not impose limits on foreign ownership.

The Iranian economy grew by an estimated 3 percent in 2014, compared to a contraction of 1.7 percent in 2013, largely due to the temporary and partial easing of sanctions. The Iranian government is pursuing a market-based reform plan to improve its economy, including strategies to increase the productive capacity of the non-oil sector and greater autonomy to the Central Bank. The potential of Iran as a destination for investment is clear and this potential could be opened up through this historic deal.

THE END OF SANCTIONS?

All of the exact provisions of the deal have yet to be disclosed, in particular the timetable for the lifting of economic sanctions on Iran. Further negotiations are still required on the question of the International Atomic Energy Agency's access to verify Iranian compliance. In essence, however, the deal appears to consist of an agreement by Iran to place two-thirds of its centrifuges used for enriching uranium into storage, and dispose of its stockpiles of low-enriched uranium. These measures together are aimed at constraining Iran's "break-out" time for acquiring a potential nuclear weapon to a minimum of 12 months.

In return for Tehran's verified compliance with these measures, the process of lifting the network of UN, EU and US sanctions against Iran will begin, allowing economic reengagement with the world. Expectations are that this process will be far from immediate, taking perhaps six months before sanctions start to be removed. Sanctions imposed through UN Security Council Resolutions are likely to be lifted first. This process would remove some of the EU sanctions that are legally based on UN resolutions. Removing other EU sanctions will require a number of EU Commission decisions and that process is likely to require a few months.

The lifting of US sanctions will be more complicated, with Congressional elements seeking to impede the process. Some US sanctions may initially be suspended through presidential waivers, given the challenge of dismantling Congressional laws. Such waivers would not, however, affect the core sanctions that Tehran is keenest to see removed, in particular the Iran Sanctions Act (the main piece of legislation barring US entities from trading with Iran). Depending on Congress, the Obama Administration may be forced to wait for the sunset clause of the

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Act to be applied on 31 December 2016 – any attempt to extend it after that would be vetoed by Obama (who will be still in office until 20 January 2017). If this is the case, key US sanctions provisions (and their extra-territorial effect on international companies) may not be lifted for another 18 months.

THE ECONOMIC OPPORTUNITY

If this deal holds in its present form – *and it is a big if* – the economic opportunities in Iran for MNCs will be significant. The first priority for the Iranian government will be to rebuild and repair its oil and gas infrastructure. There will, however, be massive pressure at a popular level to show rapid amelioration in living standards and access to desired consumer goods. The powerful Iranian *Bazaar* merchants will seize the opportunity to resume their customary import-export trade to feed consumer demands. Other needs, such as upgraded TMT systems, healthcare, transport and airline infrastructure, will need to be addressed by the Iranian government.

FAR FROM PLAIN SAILING

While the Obama Administration hailed the deal as a major diplomatic victory in reducing the threat of an Iranian nuclear weapons programme, the agreement has met mixed reviews in Washington. Republican Congressional heavyweights such as Senate Foreign Relations Chairman Bob Corker, (R-TN), Sen. John McCain (R-AZ) and House Speaker John Boehner (R-OH) remain sceptical of the deal. And although Democratic leadership in the House and the Senate praised the historic agreement, other party leaders cautioned it didn't do enough to restrict Iran's nuclear capabilities.

President Obama now has the task of selling the deal to Congress and, perhaps more critically, the American public. In a White House press conference on 15 July, Obama made the case that the agreement makes the world safe, and is the best alternative to allowing Iran's continual development of its nuclear programme. The Administration is expected to continue championing the deal and educating Congressional leaders and the public alike on the merits of this agreement as Congress prepares to review the deal's fine print.

A recently passed law gives Congress enhanced oversight over the deal. After the administration presents the accord to Capitol Hill, lawmakers have 60 days to review the agreement, hold hearings, and vote on a resolution to endorse or disapprove the deal. Congress is expected to wrap-up hearings before 7 August,

when lawmakers flee the nation's capital to their home states for summer break, and vote on a resolution when they return to Capitol Hill in September. Any efforts to block the accord will be met with a presidential veto. While it is expected that the US House can secure the votes necessary to override the veto, it is unlikely that the Senate can rally the necessary two-thirds majority. However, some observers caution there remains risk in the US Senate, especially if the White House loses the support of the public.

Meanwhile, with the US presidential election campaign season heating up, several presidential hopefuls have already voiced their position on the deal. In the Democratic camp, both former Secretary of State Hillary Clinton and Senator Bernie Sanders (I-VT) have embraced the deal. In a statement released by her campaign last night, Clinton said the agreement was the "most effective path" out of all options available to prevent Iran from advancing its nuclear weapon programme. As anticipated, Republican presidential hopefuls took aim at the agreement. In his official campaign announcement speech, Wisconsin Governor Scott Walker called the deal "one of America's worst diplomatic failures". Meanwhile, Marco Rubio (R-FL) criticised the deal, saying it "undermines our national security," while Jeb Bush chided the agreement as "deeply flawed". With the primaries swiftly advancing, White House hopefuls will likely adopt the Iran issue as part of their foreign policy platforms.

THE IRANIAN ANGLE

In recent days, there have been cautious statements from conservative elements inside Iran suggesting reservations about the deal, but no outright condemnation of it so far. Friday prayers in Tehran on 17 July are likely to be critical. This will be the final Friday prayers in this holy month of Ramadan, and the Supreme Leader, Ayatollah Khamenei, is expected to use this opportunity to signal his attitude towards the Vienna agreement. It is unlikely that he will oppose the deal outright, but he is equally unlikely to offer unqualified support. His exact words and tone will be telling. There is still a large constituency among the Islamic revolutionary elite that opposes any deal with western powers; Khamenei needs to balance their views - views with which he may, at a visceral level, sympathise.

Decision-making in Iran is complex, with competing factions and tendencies all seeking to influence policy in their favour. Some of the hardliners in the Iranian Revolutionary Guard Corps (IRGC), acting unilaterally, have resorted in the past to high-profile

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wrecking actions to disrupt previous attempts at rapprochement. Domestic centres of resistance to a deal, such as elements in the Majlis (the Iranian parliament) and the Guardian Council, may mount rear-guard actions.

The policy split between the relative modernisers (represented by President Rouhani) and the mainstream conservatives (including the Supreme Leader Khamenei) will become more apparent, with the former grouping seeing the removal of sanctions as the first step in a process of wider economic liberalisation and change, and the latter viewing the removal of sanctions as an end in itself, merely returning the Iranian economy to the *status quo ante*. How this plays out will be critical for foreign investors. It would be rash to assume that Iran will be an easy market. Even before sanctions the Majlis had a history of taking political decisions on economic nationalist grounds, overriding economic and business agreements, in sectors such as oil and gas, telecommunications, aviation and automotive. Such interventionism, particularly in strategic sectors, is likely to remain an issue.

In addition, the economic presence of the IRGC has grown substantially over the last decade, including holding large overt or hidden stakes in many companies listed on the Tehran Stock Exchange. An IRGC spokesman conceded recently that their economic interests now represent 10 percent of the total economy; the real figure is likely to be even higher. Adding in the economic weight of the *bonyads* (revolutionary foundations), large parts of the economy may be off limits to international business. While the removal of sanctions may not preclude foreign companies participating alongside IRGC entities, there may be a clear reputational risk for doing so. It will therefore be vital for entrants to the market to understand who they are dealing with either as partners or customers.

HOW SHOULD COMPANIES AND OTHER INVESTORS RESPOND?

The signing of the Vienna agreement is not in itself a starting gun for investment allocation decisions; it is the beginning of a process that will remain subject to domestic and international political agendas in both Iran and the US. From a practical perspective, sanctions may not be fully removed for 18 months; the process for lifting them may be unclear and confusing, so potential foreign investors will need to move cautiously to ensure they remain at all times compliant with any sanctions regime currently in force.

MNCs targeting the market should now look to honing their market entry strategies, but they should do so with clear and informed guidance on how best to navigate the complex business and political environment of Iran and in the full realisation that this deal may not hold in its current form.

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