

Foreign Investment in
Iran
“Post-Sanctions Strategy”

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Introduction

Eventually, after 12 years of imposing sanctions against Iran by governments and international organizations, in January 14, 2016, all banking, petroleum, insurance etc. sanctions have been lifted. This provides countless opportunities for investors and heralds an optimistic and prosperous future for various Iranian industries.

In order to find a comprehensive perception about post-sanctions circumstances, it is necessary to elaborate the rules and regulations and investment framework of Iran. This article has been drafted by a practical perspective so that the post-sanctions methods of foreign investment in Iran become understandable.

After nearly 48 years, the new law on foreign investment in Iran under the name of “*Foreign Investment Promotion and Protection Act*” (**FIPPA**) was ratified by the Parliament in 2002. FIPPA replaced the Law for the “Attraction and Protection of Foreign Investment” which was in effect since 1955. FIPPA’s replacement of LAPFI has further enhanced the legal framework and operational environment for foreign investors in Iran.

1. Methods of Foreign Investment

According to article 3 of the Iran's *Foreign Investment Promotion and Protection Act* (FIPPA), methods of investment are: (i) Foreign Direct Investment (FDI) where the activity of the private sector is permitted; (ii) foreign investment in all sectors within the framework of “Joint-venture”, “buy-back” and “build-operate-transfer (BOT)” schemes where the return of capital and profits accrued is solely emanated from the economic performance of the project in which the investment is made, and such return of capital and profit shall not be dependent upon a guarantee by the government, state-owned companies or banks.

1-1. Foreign Direct Investment (FDI)

Foreign direct investment is a kind of extraterritorial investment in a business enterprise by a natural person or a legal entity based in another country with the aim of achieving long-term profit. In this type of investment, control and management of the enterprise as a whole or in part will often be in the hands of foreign investor. Based on FIPPA, foreign direct investment attained in the following ways:

1. Through the use of foreign investment in a new Iranian company or by the purchase of an already-established company's shares by the foreign investor;
2. Through contractual arrangements between the parties with or without formation of company.

Needless to say, foreign direct investment in the private sector will only be allowed in accordance with the procedures prescribed by the Act. Furthermore,

it can be construed from article 3 of FIPPA and related regulations that Foreign investment in economic sectors that are monopolized by the government will only be permitted where the return of capital and its profits is solely through the economic activity of the same investment project and does not rely on any guarantee by the government or government companies or banks. In fact, this article states the criteria for foreign investment in the public and private sectors of the Iran's economic system.

Under article 44 of The Constitution of the Islamic Republic of Iran:

“The economy of the Islamic Republic of Iran is to consist of three sectors: state, cooperative, and private, and is to be based on systematic and sound planning.

1. The state sector is to include all large-scale and mother industries, foreign trade, major minerals, banking, insurance, power generation, dams, and large-scale irrigation networks, radio and television, post, telegraph and telephone services, aviation, shipping, roads, railroads and the like; all these will be publicly owned and administered by the State.

2. The cooperative sector is to include cooperative companies and enterprises concerned with production and distribution, in urban and rural areas, in accordance with Islamic criteria.

3. The private sector consists of those activities concerned with agriculture, animal husbandry, industry, trade, and services that supplement the economic activities of the state and cooperative sectors.

Ownership in each of these three sectors is protected by the laws of the Islamic Republic, in so far as this ownership is in conformity with the other articles of this chapter, does not go beyond the bounds of Islamic law, contributes to the

economic growth and progress of the country and does not harm society. The scope of each of these sectors as well as the regulations and conditions governing their operation, will be specified by law.”

Based on section “A” of the *General policies of the Article 44 of the Constitution of the Islamic Republic of Iran*: “Investment in and management and ownership of those sectors that fall under Article 44 are permissible by the non-state enterprises and public institutions, and the cooperative and private sectors as described below:

(i) Large-scale industries, mother industries (including large downstream oil and gas industries) and large mines (except oil and gas).

(ii) Foreign trade activities in the framework of trade and foreign currency policies of the country.

(iii) Banking operations by non-state public enterprises and institutions, publicly-held cooperatives and joint stock companies, provided maximum shareholding of each shareholder is determined by law.

(iv) Insurance

(v) Power supply, generation and importation of electricity for domestic consumption and export.

(vi) All postal and telecommunication activities, except the main telecommunication grid, assigning of frequencies and main networks of postal exchanges, routing and management of distribution of mails and basic postal services.

(vii) Roads and railways

(viii) Aviation (air transport) and shipping (marine transport).

The optimal share of the State and non-State sectors in the economic activities

covered under the preamble of Article 44 will be determined by law by taking into view the sovereignty and independence of the country, social justice and economic development and growth.”

Considering the above-mentioned *General Policies of Article 44* which has been instructed by Supreme Leader of Iran, the private sector can invest, manage and own economic activities specified in this instruction. As a result, foreign direct investment is allowed in these eight grounds by foreign investors.

1-2. Contractual Schemes

Regarding paragraph (b) of article 3 of FIPPA, foreign investment is possible in all sectors within the framework of “Joint venture”, “buy-back” and “build-operate-transfer (BOT)” schemes. These schemes are briefly discussed below.

1-2-1. Joint Ventures

The term “Joint Venture” is frequently used in the field of foreign investment, as this contractual framework is employed by investors in many legal systems for investment. The joint venture model, as a favorable contract which decrease risks and costs of investing, has always been of interest to investors. However, the application of this form of contract will be subject to compliance with the requirements which are usually determined by the laws and regulations governing the contract.

Considering the laws and regulations of an investee country, the subject matter of the project and its performance requirements, sometimes it is advisable to

build a joint venture in the form of a company which has a separate legal personality from its members and often called “corporative joint venture”. Some other times, partnering without establishing a company and through concluding a contract is a safer choice for investment, which is known as “contractual joint venture”. Partnership as a kind of contract form is not the purpose of investment, but it is a method by which foreign investors achieve their investment objectives as specified in their business plan.

In various legal systems, this form of investment has different names such as “joint venture” “partnership” “consortium” and sometimes “shareholders agreement”. In some legal systems, these titles differ in some aspects which analyzing them is beyond our brief discussion. In Iran’s legal literature, legal form of partnership is mentioned in *Civil Law* (article 501-606), *the Commercial Code* (companies’ section) and also it is implied in *Interest-Free Banking regulation* (article 18). Article 3 of FIPPA also states civil partnership as a method of investing, which can be established in the form of a joint venture.

In the corporative joint venture, partners establish a company known as a joint venture company (JVC) which is a kind of business companies with an independent legal entity, then each of them possesses specific percent of its shares. In this case, partners are known as shareholders and it is the company which is responsible for implementation of the project which is the subject of the joint venture. On the other hand, in the contractual joint venture, partners who decided not to establish a company, directly implement the investment scheme based on their contract.

1-2-2. Iran's Petroleum Contracts

Buy-back Agreement

The second method of investment which is expressed in article 3 of FIPPA is “buy-back”. In recent years, buy-back contracts, as a contractual investment technique, have had a prominent role in Iran's economy. This type of contract is mainly known for its use in the development of discovered oil and gas fields. In addition, buy-back contract is useable in other industries.

Buy-back contract is a kind of counter-trade arrangements which is also classified as a hybrid contract. It is often defined as a contract between a purchaser and vendor in which the vendor agrees to repurchase the property from the purchaser if a certain event occurs within a specified period of time. The buy-back price is usually set out in the agreement. However, the buy-back transaction has acquired a broader meaning under Iranian law. As defined by Article 2 of the Executive Rules approved by the Council of Ministers, a buy-back transaction refers to a deal in which the supplier, wholly or partially, puts the needed goods and services for the establishment, expansion, reconstruction, improvement or continued production of manufacturing enterprises of the country at the disposal of the producer.

The price of the said goods and services, after deducting the amount of down payments plus the related costs dispersed on the basis of the concluded contract, is paid to the supplier or buyer through the delivery of goods or services of the producer and/or through delivery of other industrial and mineral goods and services produced in Iran. Due to some requirements in Iran's Constitution and Petroleum Act, buy-back contracts are usually employed in the development of oil and gas fields in Iran.

Regarding oil and gas contracts, if the exploration is also under the offered scope of services, buy-back contract will be categorized as “Risk Service Contract” with the special payment procedure. According to this type of contract, contractor concludes a contract with the investee government and utilize cash and non-cash items of provided capital in order to develop oil and gas fields. Further, various costs such as contractors’ remuneration are defined in such contracts and secured by selling the produced oil and gas and through “Long Term Crude Oil Sales Agreement” which is an annex to the buy-back contract.

Iran Petroleum Contract (IPC)

These days, one of the most important debates in scientific and technical circles is optimizing contractual mechanism in the upstream oil and gas projects in Iran. In February 2014, a seminar was held in Tehran and some provisions of the new oil contracts which have been prepared by “Oil Contracts Revision Committee” unveiled under the title of “*Iran Petroleum Contract (IPC)*”. This contract has been prepared to rectify failures and gaps in different generations of buy-back contracts and is a beginning of an evolution in Iran’s petroleum contracts. On the other hand, Iran’s Parliament has played a significant role in this evolution by passing a few important laws, especially “the Duties and Powers of the Ministry of Petroleum Act” in 2012.

Iran’s new petroleum contract is not a new kind of petroleum contract alongside concession contracts, production sharing contracts, risk service contracts or joint venture. But it is a hybrid contract which contains some features of joint

venture contracts (regarding the procedure of implementing petroleum projects) and some traits of production sharing contracts (regarding the cost recovery mechanism).

Based on IPC Contracts, in the exploration stage, contractor and the National Iranian Oil Company establish an “Oil Exploration Operations Company” in which contractor leads the operation and performs exploration by using his own budget and by taking its risks. National Iranian Oil Company is a technical partner which accompanies the contractor without sharing the costs and risks of exploration. If exploration does not lead to the discovery of a commercial field, the contractor’s costs incurred in the operation will not be refunded. But if a commercial field is discovered, contractor’s costs will be transferred from the exploration stage to the development stage and will be recovered during the amortization period.

Following the discovery of commercial field and assessment operation, the project will steps into a new stage. In this phase, in order to implement a development project, another company is established which is usually known as “development operation company”.

Like the previous stage, the contractor incurs all costs and risks of development operation while he has the power to lead the operation. Once again, the National Iranian Oil Company is technical partner which accompanies the contractor without sharing the costs and risks of development operation. All direct and indirect costs of such operation which is incurred by the contractor or the National Iranian Oil Company, will be amortized by allocation of a specific percentage of products to the company.

The next phase is production operations which are more varied than exploration

and development stage. Therefore, either (i) the production operations may be implemented by the National Iranian Oil Company or its affiliated companies along with financial and technical support of contractor; or (ii) the development company also takes part in production operations; or (iii) in order to implement and manage field production operations, a production operations company is established while development company which has built in the former stage, will provide financial and technical support to the production company.

It should be noted that, based on the above-mentioned seminar's panels, the **IOR/EOR** are other responsibilities of production operations company which should be implemented and reported to the development company. Finally, at the end of a payment period, which according to the conditions of each field is ranging from 15 to 20 years, the petroleum contract is terminated.

The seminar's panels did not determine any specific forms of company for exploration and development operations, however, the production operation company will be formed as a "Non-profit Joint Operating Company".

1-2-3. Build, Operation, Transfer Contract (BOT)

According to the FIPPA, another contractual framework for investment is "Build, Operation, Transfer (BOT) Contract". This method of investment often used for building infrastructures such as power plants, telecommunications, airports and highways. Nevertheless, it can also be used in the recreational projects such as building cable cars. In BOT contracts, a government organization confers the concession of building and operation of a specific project to the private sector, and in return, the private sector is responsible for financing, designing,

supplying materials, building, testing and managing the project. During the operation period, the private sector recovers its costs and interest of its investment by selling the project's output. At the end of operation period, ownership of the facility is transferred to the government organization free of charge.

BOT contract is a kind of public-private partnership in which the government or a public sector decides to build an infrastructure project by partnering with the private sector. Experience has proven that it is much faster and cost-effective when governments build necessary facilities and infrastructures by partnering with the private sector. Choosing an appropriate company from the private sector (which is usually is a consortium) is through a tendering process, after which the state or public sector sign a BOT contract with the selected company.

1-2-4. Investment in Iran's Construction Projects

With property values exceeding those of similar-sized countries, Iran has seen a recent boom in the real estate market over 2014. Encouraged by the country's youthful demographic trends, investors are increasingly putting their faith in real estate, which has stood the test of time as a safe, fixed asset. At the same time, contractors and consultants have spotted opportunities throughout the country in terms of catering to both tourists and local residents seeking modern and convenient new homes. Investors are also eager to invest in these projects, which will satisfy growing demand and guarantee returns for years to come.

Growth is also occurring in the country's infrastructures. Iran's government and public sectors try to build or renovate infrastructures all over the country which

provides great opportunities for investors to invest in these projects by setting up public-private partnerships (BOT, BOOT, Joint venture, etc.). Such projects offer a favorable interest rate for investors' capital. In recent years, the construction industry has been thriving due to an increase in national and international investment to the extent that it is now the largest in the Middle East region.

Construction Contracts

What forms of contract are used in Iran's construction industry depends on the position of employers (owners). If an employer is a private individual or a legal entity from the private sector, any sorts of contract can be applied between the employer and a contractor. Contracting parties can negotiate almost any types of project delivery mechanism such as Design-Bid-Build, Design and Build, EPC, turnkey etc. On the other hand, if the employer is a government or public organization, there is a limited ground for negotiation upon choosing a contract form. Government and public sectors in Iran are required to utilize pre-designed forms of contract which have been issued by the government.

Selection of a Contractor

In the private sector of Iran, employers are able to negotiate with contractors directly so that they can find an appropriate contractor who has technical knowledge and adequate resources to implement the project. However, government institutes are required to use tendering process in order to choose a

contractor for implementing public projects. *Tender's Law* of Iran which was passed in 2005 provides in its first article that: "All three powers of the Islamic Republic of Iran shall follow the stipulations of this Law in organizing a bidding; this includes: ministries; public organizations, institutions, and companies; profitable institutes affiliated to the Government; public financial establishments and banks; public insurance companies" ...

Tendering Process in the state and public organizations of Iran is not an open one, but it is subject to a pre-qualification procedure after which bidders are short listed and invited to bid for the project. Based on article 12 of the *Tender's Law*: "In pre-qualification of bidders, the following shall be taken into account: (i) Guarantee on quality of services and goods; (ii) Experience and knowledge in the relevant field; (iii) Reputable record; (iv) Work permit or qualification certificates, if necessary (v) Financial capacity of the bidder for implementation, if necessary".

Pricing Methods

Contracting parties in the private sector are free to take any kinds of pricing method that they wish. Depending on the conditions of a project's site and other factors, parties can choose one of the pricing methods such as lump sum, cost plus, remeasurement, time charge, estimation etc. However, in the state and the public sector, the employer determines the pricing method which is often known as "unit price" contract. This kind of contract is based on estimated quantities of items included in the project and their unit prices. The final price of the project is dependent on the quantities needed to carry out the work.

Dispute Resolution

Similar to construction industry of many other countries, most of construction contracts in Iran refer to “Alternative Dispute Resolution” techniques to solve related disputes. Negotiation and mediation are usually applied to resolve such disputes, even so, contracting parties can agree to resort to arbitration or litigation if their dispute remains unresolved. On the other hand, where the employer is a representative of the state or public sector, a dispute resolution mechanism has already embedded in the construction contracts and it is not open to free negotiation. Although such construction contracts stipulates ADR methods in their pre-designed terms, there are notable differences between practicing ADR methods according to these contracts, and well-known procedures of performing them in other disputes. As a result, it is advisable to seek legal advice before signing construction contracts.

1-3. Foreign Portfolio Investment (FPI)

1-3-1. Iran's Stock Exchange

Tehran Stock Exchange was established in 1968, and has been the primary equities market in Iran. In 2005, the new Capital Market Law of Iran approved by parliament and in 2006, according to this Act, TSE was demutualized and established as a joint stock company with over 6000 shareholders. TSE has enjoyed a reputation for having maintained an orderly market and a cost-effective trading capability since its inception. The fully computerized trading

system has helped boost the trading capacity and efficiency of the stock market. In 1994 electronic trading systems was launched. In 2007, TSE moved to the powerful trading system (powered by Atos Euronext) for meeting the high trading volume. TSE has been awarded quality system certificate of ISO9001; in 2009 and also planned to obtain ISO27001 certification for its IT Security Management System.

TSE has implemented many reform measures in the past few years in order to bring it in line with international practice, and to better reflect investors' diversified needs. TSE is set to continue making progress towards liberalization and internationalization. The Tehran Stock Exchange, with its fully automated trading systems and book entry mechanisms, is known as one of the most active exchanges in the Middle East region. At the end of June 2011, the total market capitalization of the 342 companies listed on the Tehran Stock Exchange (TSE) amounted to US\$105 billion. The ratio of total market capitalization to GDP was about 26 % in 2010. In this year, the total trading value was US\$19 billion, representing a market turnover rate of 22.5%. The market P/E ratio of the Tehran market was 6.7, lowest among primary WFE1 exchanges, making it an attractive marketplace for investors. In order to enhance the core competitiveness of the Tehran Stock Exchange and to make faster progress towards liberalization and internationalization, the authorities have also promoted the introduction of new financial products, new financial institutions and implemented many reform measures, such as the listing of Single Stock Futures (SSF), relaxing limitations on foreign investment, streamlining foreign registration procedures, and adjusting various trading system and mechanisms so that they are more in line with international standards.

1-3-2. Tehran Stock Exchange

As with several emerging stock markets, the Tehran Stock market historically set several limitations on foreign investment. With the growth of Iran's stock market and development of the economy, the Stock market Authorities have gradually relaxed these limitations on foreign investors. Since April 2010, the process for investment by foreign investors in the stock markets has been changed from the 'permit' system to the 'repatriation' system. On 18th April 2010 Upon the recommendation of the Ministry of Economic Affairs and Finance, and by virtue of the paragraph 3 of article 4 of the Securities Market Law of I.R.I ratified in 2005, the Council of Ministers approved "*The Regulations Governing the Foreign Investment in the Exchanges and OTC Markets*". This has consequently simplified the application procedures for foreign investment in the Tehran Stock Exchange.

According to Article 7 of this "Regulations" the restrictions imposed on the possession of shares by the non-strategic foreign investors on every exchange or OTC market are set forth as follows:

The number of shares owned by the total foreign investors shall not exceed twenty (20%) percent of the total shares number of the companies listed on the exchange or on the OTC market or twenty percent (20%) of the shares number of any company listed on the exchange or on the OTC market. The number of shares owned by each foreign investor in any companies listed on the exchange or on the OTC market shall not exceed ten percent (10%) of the shares number of such companies.

Based on Article 4 the foreigners/ foreign entities shall have to submit the

required information and documents to the Organization along with an application based on the forms prescribed by the Organization so as to obtain a license for trading in securities on every exchange or OTC market.

1-3-3. Buying and Selling Stocks

a) Choose a stockbroker. In choosing a broker, you should check if that broker (person or corporation) is a member in good standing at the Tehran Stock Exchange. A complete listing of the TSE member-brokers can be found in various publications or from the TSE Membership Department. It is important that you trust your broker and that you are satisfied with the services it provides for you. Brokerage services include market reports, advice regarding the stock selection and timing of purchases and sales, trade executions, on time delivery of important documents - such as confirmation receipts - and other trading-related activities that their clients may require.

b) Open a brokerage account. Once the investor has chosen his brokerage firm, a brokerage account has to be opened. This account allows the client to perform stock transactions (buy and sell shares) any time - similar to a bank account which enables you to deposit, transfer and withdraw money. Opening a brokerage account is relatively easy to accomplish and takes no longer than opening a bank account. A specimen signature card needs to be filled out, containing the: name, address (professional and private), telephone number(s), and most importantly, the client's signature. Frequently, bank and professional

references have to be submitted.

Once an account has been opened, the client may buy or sell immediately according to the trading instructions between the investor and broker. Trading instruction can vary depending on the investors' objective - whether it is short-term or long-term, minimum or maximum value of trades (trading limit), etc. All transactions are handled confidentially and the broker will not reveal to any person the details of any purchases or sales done for his client.

c) Place your order with your broker. After opening the account, a trader will be assigned to the investor. A trader is a licensed salesman who is authorized to buy and sell securities at the TSE. The assigned trader will be your contact person for all the transactions. He/she will receive your order, most likely by telephone (unless arrangements are made), and will execute the order through the trading terminal connected to the main system of the Exchange. Thus, when placing an order to buy or sell, you have to call your trader and give the details of your order. The trader needs to know the following specifications: buy or sell order, which stock to buy or sell, the number of shares to buy or sell, and preferably also the bid price (when buying) or asked price (when selling).

d) Settle your transaction. Buying and selling transactions are settled by book-entry. This means the ownership of shares and cash is transferred electronically to the brokerage account, without the stock certificates and cash being handed over physically. The account is credited when buying shares, and debited in the case of selling shares. Tehran Stock Exchange is launching the paperless or scriptless trading that result to eliminating the physical handover

of stock certificates when buying or selling. The system replaces the scrip-based system where stock certificates are handed over for transfer to the next owner. Instead, stock certificates are simply immobilized and kept in a safe place - Central Securities Depository of Iran, Inc. The book-entry system clearly advantages over the paper-based system. It has dramatically reduced paper work, facilitated the trading and eliminated the loss or forgery of shares. Currently the TSE settles trades on T+3, i.e., four days after the transaction date. Therefore, payments and/or securities must be delivered to your broker on trading day. Be sure to always verify the settlement deadline with your broker for future transactions.

1-3-4. Global Relationship

TSE is the full member of WFE (Since 1992) and also a member and one of the founders of FEAS (Since 1995) and also a subscriber of International corporate governance network (ICGN). TSE also is an active participant of OIC Members' Stock Exchange Forum.

1-4. Issuance of Foreign Investment License

1. Application Form;
2. Establishment License / Primary agreement / Preliminary agreement of the pertinent Iranian organization;
3. Official letter of the foreign investor to submit to the OIETAI;
4. The foreign investors background including a brief history of the company, the

year of establishment area of activities in case of foreign investor is a natural person, a photocopy of passport and resume will be provided;

5. A list of machinery, equipments and CKD part which may be imported into the country as a part of the foreign investors capital (if available);

6. In case that part of the foreign investor's share is in the form of technical know-how, a draft of the contract outlining the conditions of the transfer of technology;

7. Any further useful information;

The primary objective in this process is to find a suitable and "acceptable" local partner. If the contemplated foreign investment project complies with the plan already sanctioned, the Ministry of Economic Affairs and Finance may introduce to the potentially interested foreign investor, the local partners already holding an "agreement in principle" for taking part in such a project.

A ministerial "agreement in principle" must be applied for jointly by both the foreign and the local potential investors.

Details of the project are to be submitted to the Ministry of Economic Affairs and Finance as per a standard questionnaire, together with a feasibility study. Once the agreement in principle is issued, the parties should take the preliminary steps along with implementation of the project, such as importation of the machinery, equipment and setting up the required infrastructure.

An "application for participation" is required to be filed by the foreign investor with OIETAI to the effect of participation in implementation of the sanctioned project.

Then, the process is followed by a review of the application by the Supervisory Board for Attraction and Protection of Foreign Investment.

The Foreign Department of Ministry of Economic Affairs and Finance, upon preliminary coordination with the Ministries concerned, shall prepare a comprehensive report for submission to the Supervisory Board to adopt the decision. If the project is deemed to be in the country's overall interest, the Board conveys its favored decision through MEAF for approval and issues an Investment Decree. The Decree, once issued, is the formal permission for the investor to begin operation and to import the necessary capital which will be protected under the law.

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