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Esmaeil Karimian & Partners

Oil and Gas Industry in Iran's Body of Law
"Post-Sanctions Strategy"

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Introduction

The Ministry of Petroleum of the Islamic Republic of Iran is responsible for all kinds of oil and gas activities. The Ministry by itself has got the four major subsidiaries body as follows which undertake implementation and operation of the above mentioned activities:

• National Iranian Oil Company (NIOC)
• National Iranian Gas Company (NIGC)
• National Iranian Oil Refining & Distribution Company (NIORDC)
• National Petrochemical Company (NPC)

The Iran's Unique Position in terms of hydrocarbon reserves is as follows:

I. Iran is endowed with 155 billion barrels of oil equivalent to 10.9% of the global oil reserves.

II. Iran owns 18% of the global natural gas reserves equal to 34 TCM of natural gas.

III. Iran's current exploration projects will lead to a considerable increase in the country's oil and gas reserves.

IV. Presently, 62 onshore oil fields, 16 offshore oil fields, 20 onshore gas fields, and 2 offshore gas fields are in operation in Iran.

V. 26% of hydrocarbon reserves and 50% of natural gas reserves are located across Iran's common borders with its neighbors.

Currently, Iran, with 33/6 trillion cubic meters of natural gas reserves which is equivalent to 234 billion barrels of crude oil reserves, is the world's largest owner of gas reserves.

In its last official report, National Iranian Oil Company declared that Iran's normal and natural gas reserves are more than 33/7 trillion cubic meters and the volume of normal and recoverable crude oil reserves of the country are about 157 billion barrels; Overall, with the total volume of oil and natural gas reserves of 400 billion barrels, Iran is the world's largest gas reserves.

In order to attract foreign investment in Iran's oil and gas industry, particularly after termination of sanctions, a committee known as the "Oil Contracts Review Committee" unveiled a new contract titled "Iran Petroleum Contract (IPC)" in late 2015. The primary purpose of this Contract is to make a dramatic change in the oil and gas industry of Iran. On the other hand, Iran's Parliament has also played an important role in this evolution through legislation of several laws such as "Duties and Powers of the Ministry of Oil," enacted in 2012, "Petroleum Law Reform Act" passed in 2011 and "The Fifth Development Plan" in 2010. However, The turning point of this legal evolution can be found in contractual mechanism of the implementation of projects in the upstream of oil and gas industry which is mentioned in law of "Duties and Powers of the Ministry of Oil" 2012.

In this article, the legal aspects of Iran's petroleum rules and contracts, especially for post-sanctions era, have been analyzed.

1. Laws and Regulations Governing the Oil and Gas Industry of Iran

Legal evolution of contractual mechanism of the implementation of projects in the upstream of oil and gas industry can be tracked in law of "Duties and Powers of the Ministry of Oil" 2012 and "Petroleum Law Reform Act" of 2011. However, the main step has been taken in law of "Duties and Powers of the Ministry of Oil". Article 1 of this law states: "*Ministry of Oil is established to fulfill the general policies of the Islamic Republic of Iran in the oil and gas sector, policymaking, governance, planning and monitoring of all upstream and downstream operations in the oil, gas, petrochemical and refining, and applies its sovereignty and public ownership on oil and gas resources on behalf of the Islamic government".*

In this law, section "D" of Article 3 "The investment and financing" allocated to the Investment subjects and oil contract patterns, and by the new legislative procedures, has effectively changed the contractual mechanism of implementation of projects in the upstream sector of the oil industry. Under this section, duties and powers of the Ministry of Oil regarding investment and financing are determined as follows:

"1. Approval of development and investment projects in oil, gas, petrochemical and refining industries in order to complete the production chain and create further added value;

2. Establishing effective mechanisms for attracting domestic and foreign financial resources needed to implement development projects and keeping production capacity in compliance with laws and regulations;

3. Attracting and directing domestic and foreign capital to develop hydrocarbon *fields, with priority of shared fields Through designing new contractual patterns such as cooperation with domestic and foreign investors and contractors without transferring the ownership of oil and gas stored in the tanks and in conformity with the protected production."*

It seems that the latter paragraph, with the exception of the ownership of oil and gas in the tanks and assign it to the government, implies a contraposition in which the main element of the production sharing contracts - partial ownership of foreign oil companies in production - is recognized. In other words, because in paragraph "D" of article "3", only transfer of ownership of oil and gas in the tanks to contractors is prohibited, legal authorization is given to the Ministry of Oil to conclude contracts which lead to the co-ownership of foreign oil companies in production. However, in order to eliminate some misconceptions about the production sharing contracts, the share of foreign companies might be allocated with a particular mechanism such as delivery at the border or in a certain location so that the historical negative mindset that such sharing is against Iran's Constitution can be set aside.

It seems that "Iran Petroleum Contract (IPC)" has be designed in accordance with paragraph "D" of article "3" of law of "Duties and Powers of the Ministry of Oil", in which one of the duty of the Ministry is "Attracting and directing domestic and foreign capital to develop hydrocarbon fields, with priority of shared fields Through designing new contractual patterns such as cooperation with domestic and foreign investors and contractors without transferring the ownership of oil and gas stored in the tanks and in conformity with the protected production."

Prior to the new legislations, "Buyback" was the only model for petroleum contracts in Iran's upstream oil and gas industry. By new legislations, however, the way of using partnership models has been paved and a new contract titled "Iran Petroleum Contract (IPC)" is drafted. Notwithstanding, there still is no restriction in using "Buyback" contracts. Therefore, both "Buyback" and "IPC" will be reviewed in this section.

2. Iran's Petroleum Contracts

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2.1. 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 a 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.

2.2. 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 if "*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 companied 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".

Prepared by: *ESK Law Firm Team*

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www.ESKLawFirm.com
info@ESKLawFirm.com