

Comparative Analysis of the Iranian Foreign Investment Law and the World Bank Guidelines on Treatment of Foreign Direct Investment

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1 INTRODUCTION

Foreign direct investment (FDI) is viewed by most countries as an important source of capital and technology required for economic development.¹ The increase in flow of foreign investment in the past few years has improved confidence in developing countries where foreign investment flows can improve the shortages in resources, technology and foreign exchange which in the past constrained their economic development.² The increase in foreign investment flows is triggered by the lifting of restrictions on foreign direct investment by the developing countries to liberalise their economies together with the shift by multinational corporations towards more integrated global investment and production strategies.³ Foreign direct investment is defined as the acquisition of ownership in the host state either through the formation of a new branch or subsidiary, acquisition of a controlling share in an existing domestic entity or participation in a joint venture.⁴ The promotion and encouragement of FDI flows are achieved through the investment laws of

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1 Perry, A., "Effective Legal System and Foreign Direct Investment: in Search of the Evidence" 49 *International and Comparative Law Quarterly* (2000), p. 779.

2 Mosoti, V., "Bilateral Investment Treaties and the Possibility of a Multilateral Framework on Investment Framework on Investment at the WTO: Are Poor Economies Caught in Between?" 26 *Northwestern Journal of International Law and Business* (2005), p. 95.

3 Schlemmer-Schulte, S., "The World Bank Guidelines on Treatment of Foreign Direct Investment", in Bradlow, D.D., and Escher, A. (Eds.) *Legal Aspects of Foreign Direct Investment* (London: Kluwer International Law, 1999), p. 87.

4 Nolan, J.D., "A Comparative Analysis of The Laotian Law on Foreign Investment, The World Bank Guidelines on the Treatment of Foreign Investment and Normative Rules of International Law on Foreign Direct Investment" 15 *Arizona Journal of International and Comparative Law* (1988), p. 678.



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the host countries.⁵ The FDI laws of the host state contain the legal framework governing the admission, post-admission treatment of foreign investment, protection against expropriation and payment of compensation, and dispute settlement procedure.⁶

The Iranian economy has been crippled by problems such as rising population, declining oil revenues, increasing costs of urbanisation and an ageing petroleum production infrastructure.⁷ The destruction of the infrastructure caused by the war⁸ and the restrictions imposed by the economic sanctions⁹ on Iran greatly diminished economic growth by declining foreign investment and decreasing petroleum production.¹⁰ Also the Iranian Constitution placed all major large-scale and mother industries such as the natural resources under the state monopoly¹¹ and foreigners were prevented from acquiring ownership of the mineral wealth on the basis of concessionary rights.¹² To repair the damage done to the economic sectors, Iran started an extensive reconstruction of its infrastructure through privatisation¹³ and promoting foreign direct investment to provide the needed funds, technological expertise and management skills.¹⁴ This comparative analysis of the Iranian FDI laws with the Work Bank Guidelines on Treatment of Foreign Direct Investment (the Guidelines)¹⁵ is to outline the strength and weaknesses of the Iranian investment laws with a view towards using the Guidelines as a model for a new Iranian law. The evaluation of the two sets of norms is to assess whether the Iranian FDI legal system affords adequate guarantees and protection to foreign investors against non-commercial risks. This will be achieved by establishing the efficiency and effective-

5 Carlson, S.N., "Foreign Investment Laws and Foreign Direct Investment in Developing Countries: Albania's Experiment" 29 *International Lawyer* (1995), p. 580.

6 Fatouros, A.A., "Towards an International Agreement on Foreign Direct Investment" 10 *ICSID Review: Foreign Investment Law Journal* (1995), p. 192.

7 McCary, M., "End Run on Sanctions (A Case Study on Contemporary Energy Investment in Iran)" 12 *Florida Journal of International Law* (1998), p. 271.

8 1980–1988 war with Iraq.

9 UN Security Council has adopted three resolutions (Resolution 1696 of 31 July 2006, Resolution 1737 of 23 December 2006, and Resolution 1747 of 24 March 2007) against Iran as a result of their nuclear programme. The United States enacted the Iran Sanctions Act of 1996 (originally it was Iran–Libya Sanction Act 1996) restricting any investments of over \$20 million a year in the Iranian oil industry.

10 Salamy, G.F., "A New Era of Economic Growth in Iran: Application of the Iran–United States Claims Tribunal Opinions to Bilateral Investments with Iran" 12 *The Transnational Lawyer* (1999), p. 12.

11 Iranian Constitution 1979, Article 44 defines: "government sector as 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, which are publicly owned and controlled by the state..."

12 Iranian Constitution 1979, Article 81, states: "that the granting of concessions to foreigners for the formation of companies or institutions dealing with commerce, industry, agriculture, services or mineral extraction is absolutely forbidden."

13 The Law of the Fourth Five-Year Economic, Social, and Cultural Development Plan (2005–2010), which followed the trend set by its predecessor, emphasises high growth rates, reducing the size of government, lessening government economic interference, reducing subsidies, regulating trade through tariffs, and creating institutional and legal context for an expansion of private sector activities. Available at: <http://www.mporg.ir/english/bar-4.pdf>.

14 Firoozmand, M.R., "Attracting Foreign Investment into the Iranian Refining Industry: a Law and Policy Analysis" 5 *International Energy Law and Taxation Review* (2007), pp. 2–4.

15 See "World Bank Guidelines on the Treatment of Foreign Direct Investment" 7 *ICSID Review: Foreign Investment Law Journal* (1992), p. 297.



ness of the World Bank Guidelines by covering the legal aspects of foreign investment in both systems including admission, treatment, expropriation and compensation and dispute resolution to see if lessons can be learned and benefits gained and make recommendations for reform.

The World Bank Group including the World Bank, the International Monetary Fund (IMF), International Finance Corporation (IFC) and Multilateral Investment Guarantee Agency (MIGA) prepared the Guidelines in 1992 at the request of the world community.¹⁶ The Guidelines were prepared by the World Bank to establish “general principles suggested as a guide for governmental behaviour toward foreign investors”.¹⁷ The Guidelines are not binding on governments but are intended to influence the promulgation of new laws and treaties.¹⁸ The aim of the Guidelines is to promote the international movement of capital.¹⁹ The Guidelines apply to supplement bilateral and multilateral treaties and as a source for legislating national laws governing foreign investment.²⁰ The use of the Guidelines as a model for Iranian laws is inspired by the fact that the extensive literature produced by the awards of the Iran–US Claims Tribunal²¹ had a great impact on the formulation of the Guidelines.²² The legal regime governing foreign investment under the two systems will cover in section (1) admission and establishment deals with the conditions of access of market by foreign investors, section (2) post-establishment treatment deals with the standard of treatment foreign investors receive once the investment is made including transfer of profits and capital, section (3) expropriation and compensation deals with the legal conditions and remedies when a host state takes the property of foreign investor and section (4) dispute settlement deals with the mechanism for resolution of dispute between the foreign investor and the host state government.

2 ADMISSION OF FOREIGN INVESTMENT

2.1 World Bank guidelines on admission of foreign investment

Under general international law, countries enjoy the freedom to regulate the admission of foreign investment into its territory, in the absence of treaty obligations and contractual commitments.²³ Countries have the discretion to admit or reject foreign investment in accordance with their laws, although the degree of discretion maintained

16 Rubin, S.J., “Introductory Note to World Bank: Report to the Development Committee and Guidelines on the Treatment of Foreign Direct Investment” 31 *International Legal Materials* (1992), p. 1363.

17 World Bank, above, n.15, p. 315.

18 Schlemmer-Schulte, above, n.3, p. 94.

19 Nolan, above, n.4, p. 676.

20 World Bank, above, n.15, p. 298.

21 The Iran–US Claims Tribunal was set up in The Hague under the Algiers Agreement of 1981 following the Iranian Revolution of 1978–1979 to hear the claims brought by US companies against Iran for expropriation of their assets.

22 World Bank, above, n.154, p. 313.

23 Shihata, I.F.I., “Recent Trends Relating to Entry of Foreign Direct Investment” 9 *ICSID Review: Foreign Investment Law Journal* (1994), p. 47.



differs from country to country.²⁴ A state can exercise its jurisdiction over all individuals and property when they cross its frontiers because they fall under the territorial authority of the state, which includes everything within its territory including sovereignty over the state's natural resources such as mineral deposits.²⁵ Although the degree of openness to foreign investment varies considerably, no national investment legislation is free from limitation on entry of foreign investment.²⁶ Provision on admission or entry of foreign investments into the host countries is covered by Guideline II. Section 1 of that Guideline recommends that states encourage foreign investment not only in financial terms but also in terms of the transfer of technology, managerial knowledge and skills.²⁷ The latter accompany the foreign direct investment adding efficiency and competitiveness to the benefits acquired by the host state.²⁸ Section 2 of Guideline II, outlines the principles governing admission and foreign investment. It encourages states to facilitate the admission of foreign investment by avoiding over-regulation and the creation of unnecessary bureaucratic barriers to entry.²⁹ By removing cumbersome regulations and arbitrary denials of admission by the host state, the Guideline's aim is to facilitate the admission of foreign investment.³⁰ This is favoured by states which codify a single law on foreign investment and create a one-stop agency designed to deal with applications submitted by foreign investors for approval.³¹ Section 3 of Guideline II recognises the right of states to regulate the entry of foreign investment and recommend open admission for regulating foreign investment, as certain performance requirements as a condition of admission are counter-productive, in that they may discourage foreign investors from investing in the host state or encourage evasion and corruption.³² Many developing countries require minimum local ownership by requiring entry through joint venture or requirements for export of manufactured goods, employment of local personnel, use of local components and other related restrictions.³³ Guideline II instead advocates subjecting entry to a restrictive list of investments which are either prohibited or require screening and licensing.³⁴ Sections 4 and 5 of Guideline II list exclusions that the host state can make.³⁵ These include the prohibition of those investments that are considered inconsistent with clearly defined requirements of national security.³⁶ Guideline

24 Parra, A.R., "Principles Governing Foreign Investment, as Reflected in National Investment Codes", in Shihata, I.F.I., *Legal Treatment of Foreign Investment: The World Bank Guidelines* (London: Martinus Nijhoff Publishers, 1993), p. 317.

25 Jennings, R. and Watts, A., *Oppenheim's International Law* (9th Edn, Harlow: Longmans, 1992), p. 384.

26 Shihata, above, n.23, p. 48.

27 Schlemmer-Schulte, above, n.3, p. 94.

28 Shihata, above, n.23, p. 67.

29 Schlemmer-Schulte, above, n.3, p. 95.

30 Nolan, above, n.4, p. 678.

31 Sornarajah, M., *The International Law on Foreign Investment* (Cambridge: Cambridge University Press, 1994), p. 216.

32 Rubin, above, n.16, p. 1380.

33 Sornarajah, above, n.23, p. 217.

34 Simidjyski, Y., "A Comparative Study of the Bulgarian Law on Foreign Investment and the Foreign Investment Laws of Hungary, Poland and the Czech Republic through the Prism of the World Bank Guidelines for Treatment of Foreign Investment" 9 *Florida Journal of International Law* (1994), p. 281.

35 Shihata, *Legal Treatment of Foreign Investment: The World Bank Guidelines* (London: Martinus Nijhoff Publishers, 1993), p. 157.

36 Guideline II, Section 4(a).



II also recommends the prohibition of investment which is reserved by the law of the host country for its nationals on account of the host state's economic development objectives or the strict exigencies of its national interest.³⁷ Guideline II furthermore validates prohibitions of foreign investment into the host country on the grounds of public policy, public health and the protection of the environment.³⁸ Section 6 of Guideline II encourages the host state to publish in an accessible form the information about its legislation, regulation and procedures relevant to foreign investment including information on any classes of investment which it prohibits.³⁹

2.2 Iranian law on admission of foreign investment

Admission and regulation of foreign investment in Iran is governed by the Foreign Investment Promotion and Protection Act (FIPPA)⁴⁰ of 2002 accompanied by its Implementing Regulations (the Regulations).⁴¹ Before enactment of FIPPA, the legal framework for the approval of all foreign investments in Iran was governed by the Law for the Attraction and Protection of Foreign Investments (LAPFI) which was enacted in 1955.⁴² After the Islamic Revolution all laws had to comply with the Islamic Sharia⁴³ according to the new Iranian Constitution of 1979 which adopted the Islamic law as the primary source of the law.⁴⁴ Therefore, the parliament⁴⁵ is prohibited from enacting laws which are contrary to the principles of Islam and the Constitution.⁴⁶ The courts should not enforce any secular laws which conflict with the principles of Islamic Sharia.⁴⁷ The responsibility of making sure that the laws promulgated by the parliament conform to the Islamic principles is vested with the Guardian Council⁴⁸ who reviews the laws and refers them back to the parliament for amendments.⁴⁹ Where the parliament and the Guardian Council disagree on the compatibility of the laws with the principles of Sharia and the Constitution, the matter is then referred to the Expediency Council, who makes the final decision on the matter.⁵⁰ When the parliament submitted the draft FIPPA to the Guardian Council it was rejected on the grounds of inconsistencies with Islamic as well as

37 *Ibid.*, Section 4(b).

38 *Ibid.*, Section 5.

39 Rubin, above, n.16, p. 1381.

40 Available at: <http://www.investiniran.ir>.

41 Laurence, D., "Independent Power Projects in Iran" 10 *International Energy Law and Taxation Review* (2002), p. 1.

42 Westberg, J.A., "Foreign Investment in Iran" 24 *The Business Lawyer* (1969), p. 1264.

43 Iranian Constitution 1979, Article 4 provides that 'all civil, penal, financial, economic, administrative, cultural military, political and other laws and regulation must be based on Islamic criteria'.

44 Amin, S.H., *Middle East Legal Systems* (Glasgow: Royston, 1985), p. 105.

45 Full name is Islamic Consultative Assembly.

46 Iranian Constitution 1979, Article 72.

47 *Ibid.*, Article 170.

48 The "Supreme Leader" appoints six members of the council and the parliament elects the six legal specialists from a list of candidates selected by the head of the judiciary.

49 Iranian Constitution 1979, Articles 94 and 96.

50 *Ibid.*, Article 112 requires the Expediency Council to meet on the direction of the 'Supreme Leader' in circumstances when the Council of Guardians determines that legislation promulgated by the parliament is contrary to the Islam or Constitution and the parliament is subsequently unable to meet the expectations of the Council of Guardian.



Constitutional principles, therefore the Expediency Council had to step in and finally pass the FIPPA.⁵¹ Generally, foreign investors do not require a foreign investment licence to enter the Iranian market. However, by registering their investment under the FIPPA they can enjoy the guarantees and protection offered to foreign investors. FIPPA defines foreign investors as any natural or legal persons as well as Iranian nationals who import capital from a foreign source.⁵² An important feature of FIPPA is that the definition of a foreign investor is not confined only to natural and legal persons with foreign nationality, compared with the old LAPFI which qualified foreign investors only on the basis of their nationality. According to FIPPA as long as the investment capital originates from a foreign source anyone, including Iranian expatriates, can benefit from its protections. Under Article 1 of FIPPA, foreign investors are authorised to import all types of capital including cash or in kind in the following form:

- Sums in cash;
- Machinery and equipments;
- Spare parts and tools, CKD⁵³ parts, raw materials, additives auxiliary materials;
- Patent rights, technical know-how, trade marks and brand names, and specialised services;
- Transferable dividends of foreign investor;
- Other authorised items approved by the Council of Ministers.

The entry of foreign capital into Iran is possible by converting cash into the domestic currency⁵⁴ or by using it for foreign purchases related to the investment projects.⁵⁵ The Iranian Customs will determine the value of the non-cash items (Regulations, Article 21(b)(1)).⁵⁶ Foreign investors are allowed to import capital into Iran under FIPPA provided that all domestic laws and regulations are complied with and that the investment is for the purpose of development and the promotion of production activities in the field of industries, mines, agriculture, and services.⁵⁷ Article 2 of FIPPA specifies the conditions that the investor must satisfy before importing foreign capital which are as follows:

- The investment will lead to economic growth, upgrade technology, enhance the quality of production, increase employment opportunities or increase exports and opportunities in international markets.⁵⁸

51 Laurence, above, n.41, p. 2.

52 FIPPA 2002, Article 1 defines Foreign Investor as: “non-Iranian natural and or juridical persons or Iranians using capital with foreign origin, who have obtained the Investment License referred to in Article 6.”

53 Full name is “Complete Knock-Down”.

54 Iranian Rials.

55 FIPPA, Article 11(a)–(b).

56 Sabahi, B., “Foreign Investment in Iran, in Light of the ‘Passage of the Foreign Investment and Protection Act’ (FIPPA 2002)” 2(1) *Oil, Gas and Energy Law Intelligence* (2004), p. 4. Available at: <http://www.gasandoil.com/ogel>.

57 FIPPA 2002, Article 2 states: “admission of Foreign Investment shall be made in accordance with the provisions of FIPPA and with due observance of other prevailing laws and regulations of the Country, for the purpose of development and promotion of producing activities in industry, mining, agriculture and services shall be based on the following criteria.”

58 FIPPA 2002, Article 2(a).



- The investment will not threaten national security, public interests, harm the environment, interrupt the economy and jeopardise production by domestic investors.⁵⁹
- The investment will not involve the granting of concession⁶⁰ or special rights by the government to foreign investors resulting in the creation of a monopoly.⁶¹
- The proportion of goods and services produced by foreign investments will not exceed 35 per cent in each economic sector and in each branch shall not exceed 35 per cent. Foreign investment for production of goods and services for exports except for crude oil shall be exempt from such proportions.⁶²

The percentages set by Article 2(d) above are applicable only at the time of the issuance of the investment license and thereafter no limitations are placed on foreign investors for their market shares (the Regulations, Article 8, Note).⁶³ Article 3 of FIPPA specifies two types of foreign investments that may be admitted under its provisions:⁶⁴

- Foreign Direct Investment (FDI) in those fields in which private sector activity is authorised.⁶⁵
- Foreign investment in the form of contractual arrangements through civil partnership,⁶⁶ buyback⁶⁷ and build, operate and transfer (BOT) schemes, where the return of principal and profit arises solely through the activity of the same investment project and does not depend on any guarantee by the government, government companies or banks.⁶⁸

The authority responsible for regulating the admission of foreign investment is the Organisation for Investment, Economic and Technical Assistance of Iran (OIETA) which determines the extent and ceiling of foreign participation in different economic sectors.⁶⁹ The OIETA is obliged to submit an application received from a

59 *Ibid.*, Article 2(b).

60 For definition of “concession” see Sabahi, above, n.56, pp. 6–7.

61 FIPPA 2002, Article 2(c).

62 *Ibid.*, Article 2(d).

63 Sabahi, above, n.56, p. 5.

64 FIPPA 2002, Article 3 states: “Foreign Investment admitted in accordance with the provisions of FIPPA shall enjoy the facilities and protections available under the FIPPA. Such investments may be admitted under the following two categories.”

65 FIPPA 2002, Article 3(a).

66 Such as “Joint Venture Agreements”.

67 Jackson defines buyback contracts: “a form of risk service contract, where the contractor funds all field development costs, then recover these costs, together with a fixed amount of remuneration, once it is established that there is a ‘commercially viable discovery’, from the petroleum produced from the field”, Jackson, J., “The Iranian Buyback Concession: the Principle and the Prospects”, 7 *International Lawyer and Taxation Review* (2001), p. 2.

68 FIPPA 2002, Article 3(b).

69 *Ibid.*, Article 5 states: “the Organisation is the sole official authority for the promotion of Foreign Investment in the Country, and for investigation of all issues pertaining to Foreign Investments. Applications of Foreign Investors in respect of issues such as admission, importation, utilisation and repatriation of capital shall be submitted to the Organisation.”



foreign investor to the Foreign Investment Board (the Board)⁷⁰ within a maximum of 15 days, who then examines the case and declares in writing its final decision within one month from the date of submission.⁷¹ An institutional framework of FIPPA is the establishment of the Foreign Investment Centre (the Centre)⁷² under Article 7: “in order to facilitate and expedite issues relating to admission and activity of foreign investment . . .”.⁷³ The Centre serves as a one-stop-shop for foreign investors

by providing information and advice to foreign investors (the Regulations, Article 20(1)), coordination with regard to securing necessary licenses and permits (the Regulations, Article 20(2)), coordination with regard to issuance of visas and work permits (the Regulations, Article 20(3)), coordination required for issues such as registration of joint venture companies, importation and repatriation of capital, customs and tax affairs (the Regulations, Article 20(4)), coordination among different departments of the agencies represented in the Centre (the Regulation, Article 20(5)) and finally monitoring the performance of the decision made with regard to the foreign investment (the Regulations, Article 20(6)).⁷⁴

Admission of foreign investment under FIPPA is not limited to any particular economic sector except matters relating to national security, which is reflected in Guideline II. The World Bank Guidelines suggest that admission may be subject to certain restrictions.⁷⁵ Foreign investors can enter the Iranian market without encountering any obstacles provided that the domestic laws and regulations are respected. However, unlike the old LAPFI which afforded protection to foreign investment projects involving government payment guarantees, FIPPA protection is only available to projects, which does not depend on any other type of government guarantee.⁷⁶ For example, foreign investment through BOT scheme can either have FIPPA protection or the government guarantees but not both.

3 TREATMENT OF FOREIGN INVESTORS

3.1 The World Bank Guidelines on treatment of foreign investors

Once foreign investment is admitted it comes under the domestic jurisdiction of the host state and the investor is bound to operate under and respect and conform to the host state's legal system.⁷⁷ Guideline III covers the standard of treatment to be accorded to foreign investors by their host state and particular aspects of such treat-

70 *Ibid.*, Article 7 created the Board to review and process the application for foreign investment. The chairman of the Board is the President of the OIETA who is ex-officio the Deputy Minister of Economic Affairs and Finance. Other members of the Board include Deputy Minister of foreign Affairs, the Deputy President of the State management and Planning, the Deputy Governor of the Central Bank, and the Deputy Ministers of relevant ministries as the case may require.

71 *Ibid.*, Article 6, Note.

72 All relevant agencies are required to designate a fully authorised representative to the OIETA by the highest authority of the agency. The representatives shall act as the liaison and coordinator for all issues related to their respective agency *vis-à-vis* the OIETA.

73 Sabahi, above, n.56, p. 3.

74 *Ibid.*

75 Simidjyski, above, n.34, p. 282.

76 Laurence, above, n.41, p. 4.

77 Fatouros, above, n.6, p. 195.



ment such as the transfer of investment capital and profits.⁷⁸ Section 1 of Guideline III provides that the standard of treatment recommended covers establishment, operation, management and control together with the exercise of rights in such an investment including the ultimate disposal of the investment.⁷⁹ Section 2 of Guideline III recommends fair and equitable treatment of foreign investors.⁸⁰ The standard of treatment stated in section 3 of the Guideline recommends application of national treatment to foreign investors in the granting of permits, licences and the authorisation to employ, and in the issuance of necessary entry and stay visas to foreign personnel.⁸¹ By articulating that foreign investors are entitled to full protection and security regarding ownership, control and the substantial benefits over their property including intellectual property, Guideline III qualifies national treatment even further.⁸² Guideline III prefers equal treatment among foreign investors without discrimination based on nationality, in matters which are not relevant to the national investors.⁸³ Guideline III acknowledges that there may be distinctions in the treatment of foreign investors on the basis of membership in such commercial treaty arrangements as customs unions and free trade areas, as an exception to the non-discrimination between foreign investors.⁸⁴ Guideline III recommends host states to promptly issue licences and permits to admit foreign investment.⁸⁵ Guideline III grants the host state the right to require the foreign investor to establish his inability to recruit local personnel, before authorising the employment of foreign personnel.⁸⁶ Guideline III emphasises the importance of labour market flexibility in a positive investment environment and the investor's freedom to employ top management positions regardless of nationality.⁸⁷ Section 6(1) of Guideline III allows repatriation of funds by providing for the unrestricted transfer of a reasonable part of profits of the foreign investment and the salaries, wages and savings of the foreign personnel.⁸⁸ Guideline III requires the unrestricted transfer of sums due on debts incurred in connection with the foreign investment or to discharge contractual obligations incurred in connection with the investment.⁸⁹ Guideline III emphasises the free transfer of sums realised on liquidation or sale of the assets of the foreign investment.⁹⁰ The effectiveness and timeliness of the transfer of capital is provided by section 6(2) of Guideline III, which states that the currency used in the transfer should be the currency imported by the investor where it remains convertible, currencies designated by IMF as freely useable, or currencies accepted by the investor.⁹¹ The exchange rate of the transfer of the fund should be the market

78 Simidjiyski, above, n.34, p. 288.

79 Rubin, above, n.16, p. 1381.

80 Shihata, above, n.35, p. 158.

81 Nolan, above, n.4, p. 681.

82 Schlemmer-Schulte, above, n.3, p. 96.

83 Guideline III, Section 3(b).

84 *Ibid.*, Section 4.

85 *Ibid.*, Section 5(a).

86 *Ibid.*, Section 5(b).

87 Schlemmer-Schulte, above, n.3, p. 97.

88 Shihata, above, n.35, p. 159.

89 Guideline III, Section (6)(1)(c).

90 *Ibid.*, Section (6)(1)(d).

91 Schlemmer-Schulte, above, n.3, p. 98.



exchange rate prevailing on the date of the transfer.⁹² In case of delay in transfer of funds through the central bank or other central authority, section 6(3) of Guideline III recommends the host state to pay interest on the sum at the normal rate applicable to the local currency involved.⁹³ Guideline III recommends the host state to pay compensation to the foreign investor under the applicable law for loss due to war, armed conflict, revolution or insurrections.⁹⁴ The standard for the transfer of funds indicated by Guideline III is higher than the standards to be found in many bilateral investment treaties (BIT).⁹⁵ Guideline III also recommends the host state to permit and facilitate the reinvestment of the profits and liquidation proceeds.⁹⁶

Guideline III recommends host states to

take appropriate measures for the prevention and control of corrupt business practices and the promotion of accountability and transparency in its dealings with foreign investors, and cooperate with other states in developing international procedures and mechanisms to ensure the same.⁹⁷

The host state should take measures to eliminate corruption through strong laws to ensure the business climate in which foreign investors operate outlaws corruption.⁹⁸ Tax exemptions and other fiscal incentives are dealt with in section 9 of Guideline III.⁹⁹ The offering of tax exemptions or fiscal incentives to foreign investors is discouraged by Guideline III.¹⁰⁰ The instability and unpredictability in tax regimes through provision of tax holidays and subsequent raises in tax rates to offset the initial loss of tax revenues may deter foreign investors.¹⁰¹ Guideline III instead recommends the host state adopt reasonable and stable tax rates to provide a better incentive to investors than exemptions followed by uncertain or excessive rates and in case the host state deems fiscal exemptions as justified, they should be equally made available to foreign and national investors.¹⁰² To promote investment flows to developing countries the developed countries are encouraged by Guideline III to adopt a number of measures and the granting of a fiscal incentive to investors by its home state is particularly recognised as means of encouraging investment flows.¹⁰³

3.2 Iranian law on treatment of foreign investors

In line with the principle of national treatment, Article 8 of FIPPA affords foreign

92 Guideline III, Section 6(2) provides: "such transfer as provided for in Section 6(1) of this Guideline will be made (a) in the currency brought in by the investor where it remains convertible, in another currency designated as freely usable currency by the International Monetary Fund or in any other currency accepted by the investor, and (b) at the applicable market rate of exchange at the time of the transfer."

93 Shihata, above, n.35, p. 160.

94 Guideline III, Section 6(4).

95 Sornarajah, above, n.31, p. 218.

96 Guideline III, Section 6(7).

97 *Ibid.*, Section 6(8).

98 Sornarajah, above, n.35, p. 219.

99 Rubin, above, n.16, p. 1382.

100 Nolan, above, n.19, p. 682.

101 Schlemmer-Schulte, above, n.3, p. 99.

102 Guideline III, Section 6(9).

103 *Ibid.*, Section 6(10).



investors “the same rights, protections and facilities available to domestic investors in a non-discriminatory manner”.¹⁰⁴ Under FIPPA foreign investors are accorded with a national treatment standard in compliance with the provisions of Guideline III. FIPPA also prohibits subjecting foreign investors to discriminatory treatment in accordance with provisions of Guideline III. Following the recommendation of section 5(b) of Guideline III for establishment of the positive investment environment, FIPPA does not impose limitations on the employment of foreign personnel by investors. The executive agencies are required to issue entry visas, resident permits, work permits and employment permits for foreign investors, managers, and experts, at the request of the OIETA.¹⁰⁵ Article 10 of FIPPA grants foreign investors the right to assign the whole or part of their capital investment to a domestic investor or upon approval of the Board to another foreign investor who should hold the same qualification as the original foreign investor in order to replace or become a partner.¹⁰⁶ FIPPA grants foreign investors the right to transfer abroad their capital and profits pursuant with Guideline III. The applicable foreign currency exchange rate at the time of entry or exit of the foreign capital shall be the rate officially prevailing in the banking system in case of unified exchange rates, otherwise the free market rate shall be exercised at the discretion of the Central Bank.¹⁰⁷ Foreign investors are allowed to transfer abroad the principal or the balance of the remaining capital together with earnings by giving a three-month notice to the Board provided that all outstanding obligations and payment of legal dues are fulfilled.¹⁰⁸ The profits derived from foreign investment may also be transferred abroad by the foreign investor after deduction of taxes, duties and statutory reserves.¹⁰⁹ The foreign investor is also authorised to repatriate sums for the payment of instalments for both the principal and the interest of the financial facilities together with the amounts due under the contracts in respect of patent rights, know-how, engineering and technical assistance, trade marks and brand names, management and similar contracts entered into within the framework of foreign investment.¹¹⁰ Transfers effected under Articles 13, 14, and 15 of FIPPA (principal, profit, and instalment payments) should comply with Article 3(b) which states that the return of capital for investments in the form of civil partnership, buyback and BOT schemes should not depend on government guarantees.¹¹¹ This implies that the government does not guarantee a fixed rate of return for investment projects, whereas it only guarantees the payment of damages for losses suffered by the foreign investor as result of government action.¹¹² Article 17 of FIPPA specifies the methods for acquiring the foreign exchange

104 Firoozmand, above, n.14, p. 6.

105 FIPPA 2002, Article 20.

106 Article 10 states: “assignment of the whole or a part of the Foreign Capital to a local investor and or upon approval of the Board and confirmation by the Minister of Economic Affairs and Finance to another Foreign Investor is permitted. In case of assignment to another Foreign Investor, the assignee who shall have at least the same qualifications as the initial investor, shall replace and or become a partner to the former investor from the standpoint of FIPPA.”

107 FIPPA 2002, Article 12.

108 *Ibid.*, Article 13.

109 *Ibid.*, Article 14.

110 *Ibid.*, Article 15.

111 *Ibid.*, Article 16.

112 Sabahi, above, n.56, p. 9.



required for transfers described in Articles 13, 14, and 15 which are in the following form:

- Purchase of foreign currency from the banking system.¹¹³
- Using the foreign currency earned through export of commodities produced, and/or the foreign currency earned through the services of the firm by utilising foreign capital.¹¹⁴
- Export of authorised goods and commodities by duly observing the laws and regulations.¹¹⁵

FIPPA guarantees transfer of funds by affording foreign investor protection against political risks including adverse legislation changes.¹¹⁶ FIPPA guarantees transfer of instalment payments of the foreign investor in respect of approved financial agreements for investments subject to Article 3(b) (civil partnership, buyback, and BOT), where payments of instalments are interrupted or prohibited due to adverse changes in the law.¹¹⁷ The Central Bank is under an obligation to make available a foreign currency equivalent of the transferable funds subject to Article 17(a) (purchase of foreign currency from the bank) to the foreign investor by the approval of OIETA.¹¹⁸ Any foreign capital left unused by the foreign investor may be freely transferred abroad without being subject to any restrictions imposed by foreign exchange control regulations or any other laws.¹¹⁹ FIPPA contains provision on transparency by requiring the OIETA to allow public access to all information relating to investment (Article 21)¹²⁰ and to that effect requires all government bodies¹²¹ to furnish the OIETA with reports on foreign investment implemented as well as the information required for foreign investors (Article 22).¹²² The Minister of Economic Affairs and Finance should keep the parliament up to date every six months with the performance of the OIETA with respect to foreign investment.¹²³ Foreign investors have the right under FIPPA to transfer abroad all capital and profits and to repay its borrowing, including principal and interest (Articles 13–15), in conformity with Guideline III. The World Bank Guidelines provide an exhaustive list of type of assets that the host country should allow to be freely transferred abroad which includes, profits, salaries and savings, sums due on debts or in discharge of

113 FIPPA 2002, Article 17(a).

114 *Ibid.*, Article 17(b).

115 *Ibid.*, Article 17(c).

116 Sabahi, above, n.56, p. 8.

117 FIPPA 2002, Article 17, Note 2 states: “with respect to investments referred to in Para (b) of Article 3 of FIPPA, if as a result of enactment of legislation or Cabinet decrees, the execution of the financial agreements approved within the framework of FIPPA is prohibited or interrupted, the resulting losses, up to the maximum of instalments at maturity, shall be provided and paid by the Government. The scope of acceptable commitments within the frameworks of FIPPA shall be approved by the Council of Ministers.”

118 *Ibid.*, Article 17, Note 3.

119 *Ibid.*, Article 18.

120 The public should have access to all information including the investment, foreign investors, investment opportunities, Iranian partners, field of activity.

121 Which include all ministries, government companies and organisations as well as public institutions.

122 Sabahi, above, n.56, p. 8.

123 FIPPA 2002, Article 23.



contractual obligations, sums in compensation for war loss or similar damage and sums realised on liquidation of the assets of the foreign investment.¹²⁴

4 EXPROPRIATION AND COMPENSATION

4.1 World Bank Guidelines on expropriation and unilateral alterations or termination of contracts

The subject of expropriation of foreign investment is covered in Guideline IV.¹²⁵ Section 1 of Guideline IV prohibits states from expropriating or otherwise taking a foreign private investment partially or in whole except in pursuance in good faith of a public purpose, without discrimination based on nationality and against payment of appropriate compensation.¹²⁶ According to Guideline IV compensation is deemed appropriate if it is adequate, effective and prompt.¹²⁷ Compensation is deemed adequate if it is based on the fair market value of the taken asset measured immediately before the taking occurred or the decision to take the asset became publicly known.¹²⁸ Guideline IV recommends agreements between the state and the foreign investors on the method of determining the fair market value.¹²⁹ Guideline IV suggests that the fair market value be assessed by determining the price that a willing buyer would normally pay a willing seller after taking into account the nature of the investment, the circumstances in which it would operate in the future and its specific characteristics.¹³⁰ Examples of appropriate ways for determining the market value of an investment are provided in section 6 of Guideline IV with the different methods of valuation for different types of assets.¹³¹ Section 6(a) states that the accepted method of valuation to pay compensation to an enterprise as a going concern is discounted cash flow.¹³² For an enterprise lacking profitability, Guideline IV suggests compensation based on liquidation value, which is the amount that a willing buyer would pay for the entire assets of the enterprise less the enterprise's liabilities.¹³³ For any other assets Guideline IV recommends determining compensation based on either the replacement value or the book value at the date of the taking.¹³⁴ The effectiveness and timeliness of the compensation is discussed in sections 7 and 8 of Guideline IV.¹³⁵ Section 7 of Guideline IV deems compensation effective if it is paid in the currency brought by the investor where it remains convertible, in another currency designated as freely usable by the IMF or in any other

124 Nolan, above, n.4, p. 684.

125 Simidjiyski, above, n.34, p. 299.

126 Shihata, above, n.35, p. 161.

127 Guideline IV, Section 2.

128 *Ibid.*, Section 3.

129 *Ibid.*, Section 4.

130 *Ibid.*, Section 5.

131 Schlemmer-Schulte, above, n.3, p. 100.

132 Shihata, above, n.35, p. 162.

133 Guideline IV, Section 6(b).

134 *Ibid.*, Section 6(c).

135 Rubin, above, n.16, p. 1383.



currency accepted by the investor.¹³⁶ Compensation is prompt if it is paid without delay and, provided the state can prove that it is suffering from a foreign exchange shortage, the payment can be deferred.¹³⁷ Guideline IV authorises the expropriation of investment through the courts of law in cases where the foreign investor has breached the laws of the host state.¹³⁸ In such circumstances the foreign investor is not entitled to compensation and further claims by the investor for compensation shall be referred to the dispute settlement mechanism of Guideline V.¹³⁹ For example, in situations where the investment is used as a conduit for drug trafficking or for other criminal activity or involving gross violations of anti-trust or environmental laws.¹⁴⁰ Guideline IV recommends negotiation between the host state and the investor's home state or failing such negotiations through international arbitration for determining the value of compensation for expropriation resulting from comprehensive non-discriminatory nationalisation taking place in the context of large-scale social reforms following exceptional circumstances of revolution, war and similar exigencies.¹⁴¹ There will be inequality of bargaining power between the capital-exporting and capital-importing country in negotiation and on an equitable level section 10 of Guideline IV favours the more powerful home state and the foreign investor.¹⁴² Section 11 of Guideline IV holds a state responsible for unilateral alteration or termination of contracts, when a state acts as a sovereign and not as a contracting party.¹⁴³ Guideline IV treats such a state practice to unilateral change, termination and repudiation as a form of expropriation pursuant with section 1 and requires the state to pay compensation in accordance with sections 2–9.¹⁴⁴ Section 11 of Guideline IV also provides that where the state is a contracting party, repudiation of contract for commercial reasons will be governed by the applicable law of the contract.¹⁴⁵

4.2 Iranian law on expropriation and compensation

The fundamental protection offered by FIPPA to foreign investors relates to nationalisation or expropriation. FIPPA provides that

foreign investment shall not be expropriated or nationalised unless for the public purpose, through operation of a due legal process, in a non-discriminatory manner, and against payment of appropriate compensation based on the actual value of the investment immediately before the expropriation.¹⁴⁶

The foreign investor should make a request for payment of compensation to the Board within one year following the occurrence of expropriation or nationalisa-

136 Shihata, above, n.35, p. 163.

137 Guideline IV, Section 8.

138 Sornarajah, above, n.31, p. 221.

139 Guideline IV, Section 9.

140 Schlemmer-Schulte, above, n.3, p. 102.

141 Guideline IV, Section 10.

142 Nolan, above, n.19, p. 686.

143 Rubin, above, n.16, p. 1384.

144 Guideline IV, Section 11.

145 Sornarajah, above, n.31, p. 222.

146 FIPPA 2002, Article 9.



tion.¹⁴⁷ Any disputes arising as a result of expropriation or nationalisation shall be resolved through the dispute settlement mechanism provided in Article 19 of FIPPA.¹⁴⁸ As regards payment of compensation, Article 9 imposes an obligation on the government to pay appropriate compensation for expropriation of foreign investment without providing the definition of appropriate compensation. The World Bank Guidelines envisage payment of appropriate compensation, which is defined as adequate, effective and prompt.¹⁴⁹ The effective payment of compensation can be inferred from Article 12 which guarantees free and convertible currency, and payment of prompt compensation is evident in Articles 13–15 which guarantees the transfer of the foreign currency without delay.¹⁵⁰ Therefore, it could be argued that FIPPA guarantees adequate, effective and prompt payment of compensation in conformity with Guideline IV. FIPPA grants the foreign investor the right to claim compensation for damages incurred as a result of adverse legislative changes (Article 17, Note 2). Commentators argue that “this is a reassuring guarantee against ‘creeping expropriation’ and practically works as a stabilisation clause for the investment license”.¹⁵¹ The responsible authority to determine the scope of the government obligation in respect of the payment of compensation for adverse alteration of the laws is the member Minister of the High Council for Investment and the extent of losses incurred by the foreign investor will be determined by the Board.¹⁵² A shortcoming of FIPPA is that the payment of compensation for damages incurred as a result of adverse changes of the laws is confined to only project finance agreements (civil partnership, buyback, and BOT schemes) and therefore FDI projects are not entitled to receive compensation.¹⁵³ In conclusion, Article 9 of FIPPA is compatible with provisions of Guideline IV on protection against expropriation and nationalisation of foreign investment and the obligation for payment of appropriate compensation. Generally, FIPPA prohibits any action which leads to expropriation of foreign investment or nationalisation pursuant to Guideline IV. The grounds for expropriation of foreign investment provided by FIPPA follow the provisions of Guideline IV by requiring expropriation to be for the public purpose, in a non-discriminatory manner and through the legal proceedings. FIPPA grants foreign investors the right to seek appropriate compensation for expropriation in compliance with Guideline IV. The prohibition of discriminatory treatment of the foreign investor contained in Guideline IV is also addressed by FIPPA. The World Bank Guidelines set up the parameters, time and method for the determination of a fair market value of investment.¹⁵⁴ FIPPA guarantees payment of appropriate compensation based on the “actual value” of the investment immediately before the expro-

147 *Ibid.*, Article 9, Note 1.

148 *Ibid.*, Article 9, Note 2.

149 Simidjiyski, above, n.34, p. 301.

150 Sabahi, above, n.56, p. 10.

151 *Ibid.*, n. 56, p. 9.

152 FIPPA 2002, the Regulations, Article 30.

153 Laurence contends that if the project company own assets rather than merely operate them it may claim protection under Article 3(a) in which case the protection against government action will not be available. See Laurence, above, n.41, p. 5.

154 Simidjiyski, above, n.34, p. 302.



priation, which is an improvement compared with the “fair compensation”¹⁵⁵ test contained in the old LAPFI which was deemed as arbitrary and subjective treatment of foreign investors.¹⁵⁶ However, the term “actual value” is not defined by FIPPA, therefore it is not clear to what extent it corresponds to the term fair market value suggested in the World Bank Guidelines.

5 DISPUTE SETTLEMENT

5.1 World Bank Guidelines on settlement of disputes

The settlement of disputes is addressed by Guideline V.¹⁵⁷ Section 1 of Guideline V encourages negotiations between the foreign investor and host state to resolve their disputes if the negotiations fail to refer their dispute to the courts of the host state or through independent arbitration.¹⁵⁸ Section 1 of Guideline V acknowledges that recourse to arbitration is dependant on agreement between the parties.¹⁵⁹ Guideline V defines independent arbitration as ad hoc or institutional arbitration agreed upon in writing by the state and the investor or between the state and the investor’s home state where the majority of the arbitrators are not solely appointed by one party to the dispute.¹⁶⁰ If the parties agree on independent arbitration, states are encouraged to accept the settlement of such disputes through arbitration under the World Bank International Centre for Settlement of Investment Disputes (ICSID) if the state is party to the ICSID Convention or through the ICSID Additional Facility if it is not a party to the Convention.¹⁶¹ In suggesting arbitration under ICSID, the Guidelines adhere to the prevailing trend in international law.¹⁶² The Centre was created by the World Bank in 1965 by adoption of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention).¹⁶³ The states are encouraged by Guideline V to accept ICSID arbitration.¹⁶⁴

5.2 Iranian law on settlement of disputes

An important feature of FIPPA is the provision on the dispute settlement mechanism which was not available under the old LAPFI. Under LAPFI investors could only resort to the domestic courts of Iran in case of a dispute with the government. However, Article 19 of FIPPA states that, where disputes between the government

155 Westberg argued that the definition contained in LAPFI “states in effect that ‘fair compensation’ means ‘normal value’ of the assets measured as of immediately prior to the expropriation. While the meaning of the term ‘normal value’ is not entirely clear, as used here it is understood to mean what we would call the ‘going concern’ value in normal circumstances”, Westberg, above, n.42, p. 1273.

156 Laurence, above, n.41, p. 6.

157 Simidjyski, above, n.34, p. 307.

158 Shihata, above, n.35, p. 164.

159 Schlemmer-Schulte, above, n.3, p. 103.

160 Guideline V, Section 2.

161 *Ibid.*, Section 3.

162 Nolan, above, n.30, p. 688.

163 Simidjyski, above, n.34, p. 308.

164 Sornarajah, above, n.31, p. 223.



and foreign investors cannot be resolved by negotiations it should be referred to the domestic courts, unless other dispute settlement mechanisms are agreed in the bilateral investment treaty (BIT) with the home government of foreign investor.¹⁶⁵ This means that the foreign investors can refer to arbitration to resolve their disputes in compliance with Guideline V. Iran has signed more than 40 BITs with other countries and the dispute settlement mechanism includes arbitration under ICSID or UNCITRAL Arbitration Rules.¹⁶⁶ A shortcoming of FIPPA is the pre-condition for the existence of BIT providing for arbitration as the dispute settlement mechanism before parties can resort to arbitration proceedings. An obstacle for foreign investors involved in a dispute with the government is the Constitutional requirement prohibiting recourse to arbitration without the prior approval of the parliament.¹⁶⁷ Therefore, investors wishing to settle disputes arising out of contract with the government through arbitration must obtain the parliament's approval.¹⁶⁸ This implies that the approval of the parliament is required before arbitration can take place even where a suitable BIT exists with the home state of the investor.¹⁶⁹

6 CONCLUSION

FIPPA contains many modern and comprehensive provisions which are compatible with the World Bank Guidelines such as free admission of FDI, national treatment standard, protection against expropriation and payment of compensation in the event of nationalisation or expropriation of foreign investment, guarantee for transfer of funds and dispute settlement procedure for resolution of disputes between the investor and the government. FIPPA also recognises foreign investment through contractual arrangements such as civil partnership, buyback and BOT schemes, together with investments in the form of non-cash, including trade mark, know-how and technical services. FIPPA affords foreign investors protection against political risks such as adverse legislative changes. FIPPA, while containing extensive provisions for attraction of foreign investment, requires reform to facilitate greater flow of foreign investment by considering further measures in order to enhance its FDI framework, including:

- Remove the restriction on the market shares of the foreign investment, which is 25 per cent of the economic sector and 35 per cent in each branch;

165 FIPPA 2002, Article 19 states: "disputes arising between the Government and the Foreign Investors with regard to their respective mutual obligations within the context of investments under FIPPA, if not settled through negotiations, shall be referred to domestic courts, unless the law ratifying the Bilateral Investment Agreement with the respective government of the Foreign Investor provides for another method for settlement of disputes."

166 Sabahi, above, n.56, p. 12.

167 Iranian Constitution 1979, Article 139 provides: "the settlement of disputes concerning public or government property or its referral to arbitration shall in each case depend on the approval by the Council of Ministers and must be notified to the Assembly."

168 Gharavi, H.G., "Update, Thought and Perspectives on Iran's International Arbitration Regime" 4 *Swiss Arbitration Bulletin* (2001), p. 725.

169 Laurence, above, n.41, p. 7.



- Remove the restriction on the ability of the foreign investor to obtain government guarantees for project finance agreements (civil partnership, buyback and BOT schemes) by allowing investors to benefit from both FIPPA protection and government guarantees;
- FIPPA protection against political risks such as adverse changes of the laws which are enjoyed only by project finance agreements (civil partnerships, buyback and BOT schemes) should equally apply to FDI projects;
- Foreign investors should be allowed to have recourse to arbitration without the requirement for the existence of bilateral investment treaties with the investor home state;
- Recognition of other contractual methods of investments in the energy sector such as the “production sharing agreements” in addition to the currently accepted civil partnerships, buyback and BOT schemes.

It is with these measures and continued improvement of the investment climate that the Iranian authorities will further encourage investors to choose Iran as an FDI location.

