A New Paradigm for Attracting Foreign Investments: Restructuring Investor-State Arbitration for Resolution of Petroleum Disputes: Dynamics of the New Iranian Oil Investment Contract
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A New Paradigm for Attracting Foreign Investments: Restructuring Investor-State Arbitration for Resolution of Petroleum Disputes: Dynamics of the New Iranian Oil Investment Contract

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Introduction

Iran is a major supplier of petroleum products to global markets. Currently, the country is estimated to contain over 150 billion barrels of proven oil reserves, which is 9.3% of the world’s total, and over 12% of OPEC’s collective stockpile.¹ Iran ranks among the world’s top three holders of both proven oil and natural gas reserves. The strategic location of Iran provides secure transit route for export of oil and gas resources from the Caspian Sea and Persian Gulf to Europe that is currently dependent on Russia for its energy supplies. Iran’s oil and gas sector has suffered for many years due to the destruction caused by the Iran-Iraq war (1980-88), mismanagements and under-investments, ageing refineries, decreased production and economic sanctions. This article critically analyses the legal developments in Iranian energy sector with a view to highlight the new government policies relating to oil and gas investments. This thesis advances the hypothetical argument concerning the emergence of a new paradigm for attracting foreign direct investment through international harmonisation of investment laws. What are the implications of restructuring investor-state arbitration system for resolution of petroleum disputes? Does the international character of legal systems have an impact on the investor’s decision to choose a location for FDI operations? What are the components of an ideal legal system for foreign direct investment? In answering these questions, the author will critically analyse the role of bilateral investment treaties (BITs) in shaping the international legal order concerning liberalisation of foreign investment and trade in the energy sector. The common denominators in investment treaties are the building blocks for structuring an international sound legal system for foreign investment. Section 1 discusses the impact of the nuclear deal on oil sanctions. Section 2 covers new Iranian government’s energy reform policies. Section 3 highlights the conditions for admission and establishment of foreign investments in the oil and gas sector. Section 4 deals with the new investment model for the development of oil and gas resources. Section 5 highlights the criteria for an investment friendly system. Section 6 exemplifies the arbitration laws governing oil and gas disputes. Section 7 covers recognition and enforcement of foreign arbitral awards. The last section is conclusion.

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¹The Business Year, Iran 2013, 73
1. The impact of the nuclear deal on oil sanctions

The nuclear deal between Western powers and Iran negotiated in November 2013 in Geneva came into force on 20 January 2014. The Geneva accord was a turning point in the history of the Iran-United States (US) relations as high level diplomats from both side met for the first since the Islamic Revolution 1979 that had ended diplomatic ties between the two countries following the US embassy crisis, to negotiate a final nuclear agreement. In February 2006, the IAEA\(^2\) Board of Governors referred Iran’s nuclear case to the United Nation’s (UN) Security Council under Chapter 7 of the UN Charter that gives the UN necessary powers to make recommendations, adopt provisional measures and authorise use of force against a non-complying Member State. Since 2006, the UN Security Council has adopted five resolutions against Iran for pursuing nuclear programme by requiring Iran to suspend its nuclear activities and imposed travel ban and freezing asset of individuals and companies connected with Iran’s nuclear programme. The European Union sanctions against Iran is by far the most comprehensive and exceeds the UN sanction regime by prohibiting companies from Member States to engage in transaction involving energy, shipping, aviation, banking, insurance, and military sectors. The US government has also imposed unilateral sanctions against Iran with extra-territorial application therefore, US and non-US persons including their subsidiaries dealing with Iranian entities on the sanctions list will be fined and subject to criminal prosecution by US authorities and will not be awarded contract and aid by US government and denied access to the US financial markets. In an interview with Financial Time, the former head of Tehran’s Chamber of Commerce, said that, the nuclear deal with the so called P5+1 – the five permanent members of the United Nations Security Council (US, UK, France, China, Russia) and Germany ‘had raised hopes that a new chapter may open in trade ties.’\(^3\) On January 12\(^{th}\) 2014 the six world powers and Iran reached an agreement that sets out the details of a joint plan of action (JPA) to freeze Iran’s nuclear programme for six months.\(^4\) At the Geneva meeting, Western powers have agreed to relax certain sanctions in return for Iran to cease 20% enrichment of uranium. The UN’s nuclear watchdog, the International Atomic Energy Agency (IAEA) will monitor and inspect the nuclear facilities to ensure Iran is complying with terms of the interim deal. In return, Iran will begin to receive, in monthly instalments, some $4.2 billion in blocked funds; the Iranian parliament estimates to be total of $60bn in mostly oil revenues. Sanctions will be suspended on gold and precious metal trading, auto sectors, and purchase of aeroplane parts and medical and health-related initiatives.\(^5\) However, the clock is ticking for reaching a comprehensive long-term pact which experts believes can be achieved through ‘a series of extensions of the interim deal with incremental adjustments and reciprocal concessions on both sides every six months to keep the process alive.’\(^6\) At the time of writing this article the parties are negotiating in Switzerland to

\(^2\) International Atomic Energy Agency
\(^3\) ‘Easing of Sanctions Raises Hopes for Iranian Economy’ (January 19\(^{th}\), 2014) Financial Times
\(^4\) ‘Negotiating with Iran: a Big Gap to Close’ (January 18\(^{th}\) 2014) The Economist
\(^5\) ‘Easing of Sanctions Raises Hopes for Iranian Economy’ (January 19\(^{th}\), 2014) Financial Times
\(^6\) ‘Negotiating with Iran: a Big Gap to Close’ (January 18\(^{th}\) 2014) The Economist
reach a final deal before the end of March deadline. The lifting of sanctions will benefit the petrochemical sector, which is ready to boost production and increase exports. Iran produced $15 billion in petrochemicals, most of which were exported, two years ago but that dropped to $10 billion due to sanctions. The impact of the deal on short-term oil market is limited as many of the major restrictions on oil exports under the European Union (EU) oil embargoes remain in place. These restrictions include sales of refined petroleum products to Iran and against long-term investment in Iran’s energy sector. Under the deal, the Iranian crude oil exports will remain at current level of 1 million b/d, significantly lower than the pre-sanction level of 2.5 million b/d. In six month’s time if the current agreement is extended to allow no limit on export sales, the real impact of Iran’s potential return to the market will only become clear. The Iranian oil industry will have substantial work to do at such a time, in order to increase production to pre-sanction levels, which may open up number of opportunities for the international oil field service sector.

2. Government’s energy policies

The Iranian government’s policies on economic planning and energy reform are contained in Five-year Economic Development Plans. The Planning and Budget Organisation is responsible for gathering data and information on the developmental needs of the country including public utility infrastructure investments and submits them to the parliament for their approval and ratification. The economic development plans are enacted into law to be implemented by state organs. The financial resources and funds for implementing the energy polices are set out in the budget law.

2.1 Economic Development Plans

The current Fifth Development Plan covers 2010 and 2015 and sets out detailed provisions on development of upstream petroleum. The Ministry of Oil should create a competitive climate through issuing permits for the exploration, development and production of the oil and gas fields to increase the oil output by one million barrels per day and natural gas by two hundred and fifty million cubic meters. The Ministry of Oil should prioritise joints fields and South Pars Gas Field, following the approval of the technical and economic plans by the Economic Council and pursuant to provisions of the national budget law and exchange of agreements with the Deputy, shall take the following actions:

7 ‘Easing of Sanctions Raises Hopes for Iranian Economy’ (January 19th, 2014) Financial Times
8 ibid
9 ‘Iran Deal to Have Limited Impact on Oil Market’ (January 2014) Petroleum Review 9
10 ibid
11 ibid
12 ibid
13 Law of the Fifth Five-Year Economic, Social and Cultural Development Plan (2010-2015) art 125(a)
1) Utilisation of the methods for the exploration, development and production for a defined period of time in oil and gas field.

2) Placement for the issuance of foreign and domestic currency bonds in Iran and abroad pursuant to the applicable laws and regulations without any government guarantees.

3) Utilization of buyback arrangement in accordance with principles and conditions laid down in article 14(b) of the Fourth Development Plan.\textsuperscript{14}

Article 14(b) of the Fourth Plan authorized the NIOC to enter into contracts with foreign investors or qualified domestic companies for the exploration and development of upstream oil and gas fields to increase oil production.\textsuperscript{15} The provisions of article 14(b) set forth the conditions for exploration and development contracts as follows:

1) The government retains sovereignty and proprietorship rights over oil and gas resources.

2) There should not be any guarantee by government, state banks and Central Bank of Iran (CBI) regarding obligations on returns of investment.

3) The return of original investment, remunerations or profits, risk and costs accrued for securing financial resources and other costs incurred for the purpose of implementation of the project must be allocated from portion of products recovered from the field or revenues which must be based on the market price of sold products.

4) The contracting party must bear the risk associated with not achieving the targets set by the contract, the fields are non-economic, or quantity of products recovered from the field are inadequate.

5) Set the rate of return of investment for the contracting party that must be commensurate to the circumstances of each projects and observe the incentives for the employing optimized methods for excavation, development and utilization of fields.

6) To guarantee sustainable production of oil and gas during the contract period.

7) Observation of the domestic content rules.

8) Observation of laws and regulations concerning environment protection.\textsuperscript{16}

Ministry of Oil is authorized to take action for discovery and exploration of more oil and gas fields in the entire country and transfer and use of new technologies for exploration operations in particular the onshore and offshore joint fields shared with neighbouring countries in which the relating exploration operations concerns risk-taking by the contracting party and leads to discovery of fields capable of commercial production.\textsuperscript{17} The Ministry of Oil is permitted to conclude buyback agreement for achieving the aforementioned goals covering exploration and development of new fields by holding tenders and select the contracting party in accordance with

\textsuperscript{14} ibid


\textsuperscript{16} ibid art 14(b)

\textsuperscript{17} The Fifth Plan art 126
the legal requirements. The repayment of exploration costs including direct and indirect costs should be stipulated within the framework of agreements accompanied by development costs from the source of sale of produced goods from the same field. The issued permits are valid for a defined period of time to be determined by the Ministry of Oil on a case-by-case basis and the permit can be renewed only once. In case of completion of exploration stage, no commercial field is discovered in any of the areas in the block, the agreement will come to an end and the contracting party will have no right to claim any amount. The Fifth Development Plan sets out the obligations of the Ministry of Oil concerning implementation of oil and gas projects. The Ministry of Oil should take action for exercising sovereignty and ownership rights over the oil and gas resources and to execute legal duties by designing a management plan for the exploration, development and production. The Ministry of Oil shall equip the organisational posts by employing skilled work force and deployment of available human resources for undertaking duties stipulated in this law and other relevant laws. The Ministry of Oil should adopt a framework concerning exploration activities, development, extraction and production of oil and gas by companies affiliated to the Ministry of Oil and qualified companies concerning sustainable production and to issue permits for exploration without conferring ownership rights over the produced oil and gas. The Ministry of Oil must take action on the basis of an approved plan, concerning the supervision of exploration, development and production operations of above mentioned companies from the point of view of production, quantity, preservation of the deposits, health and safety, and environmental standards.

2.2 Budget Act

The Budget Act outlines the expenditure of government concerning oil and gas investment. In order to exercise right of ownership and sovereignty over oil and gas reserves and for the implementation of provisions of the Fifth Development Plan, the financial relationship and methods of settlement of account between government and Ministry of Oil shall be through relevant subsidiaries. These include total expenditure and costs of investments of aforementioned subsidiaries including buyback facilities, repayment of facilities, production, preservation of production level and sustainable recovery and increased production in oil and natural gas. Also the costs of exports shall be calculated on basis of transportation costs and insurance (CIF) equivalent to 14.5% from the value of exported oil (crude oil and condensate gas) and delivery of

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18 Ibid
19 Ibid
20 Ibid
21 Ibid
22 Ibid art 129(a)
23 Ibid art 129(b)
24 Ibid art 129(b)
25 Source: Official Gazette of the Islamic Republic of Iran (Persian) (translated by author)
26 Budget Act 2013 art 3(1)
condensate gas to petrochemical complexes and other companies.\textsuperscript{27} The deposited payments concerning supply of feedstock to domestic refineries shall be determined on the basis of prices of petroleum products for sale in domestic market for 2012-2013 and after deduction of costs it shall enjoy exemption from payment of taxation and the distribution of profits of shares will be determined in the form of company shares.\textsuperscript{28} For the realisation of contents of article 229 of The Law of Fifth Plan, the residues of foreign exchange resources accrued from increase of prices and quantity of exported crude oil and condensate gas in proportion to calculation structure forming subject-matter of this provision after the deduction of share of National Development Fund with ceiling of $ 7 billion starting in 2012-2013 and on a quarterly basis shall be allocated to the company solely for the purpose of investment in oil and gas projects and priority shall be given to joint fields. The aforesaid amount shall not be treated as income of the company and shall be for purpose of securing the capital resources of the company. The Ministry of Oil through subsidiary companies should pay equivalent to 85.5\% of balance of the amount mentioned in this provision to credit account of government (national treasury) and pursuant to this provision settle accounts with the government (national treasury). In case of income generated from proceeds of exports of crude oil and condensate gas exceeds the facts and figures contained in this law, 25\% of the residue income shall be added to shares of the above-mentioned subsidiary company of the Ministry of Oil, as capital resources for the sole purpose of implementing upstream oil and gas projects in particular shared fields. The Ministry of Oil through its subsidiary company can conclude necessary contracts with companies operating and producing oil and gas from its share of capital on the basis of determined price and within the framework of operating budget.\textsuperscript{29} The Ministry of Oil is authorised for purpose of securing capital expenditure and through subsidiary company to sell petroleum \textit{sukuk} (Islamic bonds) or foreign exchange bonds not exceeding $10 billion from internal resources of the company on the condition that the original capital and profit are repaid.\textsuperscript{30} The Oil Minister and the managing director of the company shall be responsible for determining the sale through coordination of the Central Bank of Islamic Republic of Iran and in conformity with applicable laws and regulations.\textsuperscript{31}

3. Admission and establishment of IOCs

This section analyses the current legal framework governing oil and gas investment by highlighting the rules and regulations concerning entry and admission of foreign investors into the energy market with a special focus on the petroleum sector. The municipal laws and regulations set out the rules and procedures for admission of foreign companies into Iranian

\begin{footnotesize}
\textsuperscript{27} ibid
\textsuperscript{28} ibid
\textsuperscript{29} ibid
\textsuperscript{30} ibid art 3(11)
\textsuperscript{31} ibid
\end{footnotesize}
industries. Under the Iranian law, foreign investors are required to incorporate a local company to carry out their business activities in Iran. As a first step, IOCs will negotiate with the NIOC and sign a Memorandum of Understanding (MOU) containing expression of interest by parties to participate in onshore or offshore projects for the exploration and development of oil and gas fields.

3.1 Foreign Investment Promotion and Protection Act (FIPPA)

The Foreign Investment Promotion and Protection Act (FIPPA) 2002 is the law governing foreign investments in Iran. FIPPA protection applies to investments undertaken for the purpose of development and promotion of production activities in industries, mining, agriculture and services. FIPPA defines investment as utilisation of foreign capital in new or existing economic enterprises after obtaining an investment license. Foreign capital is defined as various types of capital, cash or in kind, imported into the country by the foreign investor. The list of capital transfers include foreign currencies, machines factory equipment, accessories, operational facilities, tools, raw materials, individual parts, complete knock-down, foreign patents, technical know-how and trade marks. FIPPA adopts “transaction-based model” and protects the underlying capital transfers. In contrast, Iranian investment protection treaties adopts “asset-based model” that protects assets owned and controlled by foreign investors (see subsection 5.3). FIPPA recognises foreign direct investment (FDI) and non-equity based contractual arrangements, therefore both types of equity and debt investments are accepted and admitted. FDI covers direct investments in fields of activities that are open to the private sector (art 3(a) FIPPA). FDI is acquisition of ownership in the Iranian market through establishing a new company, purchase of shares of an existing company, registration of foreign branch and subsidiaries, and participation in joint ventures with local partners. Non-equity based investment contracts are permitted in all sectors within the framework of civil partnership, buyback and build, operate and transfer (BOT) schemes.

3.2 New Privatisation Act

The Iranian constitution law divides the Iranian economy into three sectors: state, cooperative and private. Article 44 of the same law designates oil and gas sector as large mines and mother industries, the control and management of which shall be vested solely with the state, therefore, foreign private sector were excluded from the oil and gas sector. Furthermore, pursuant to article 3(a) of FIPPA, foreign direct investment is possible in sectors of the economy in which the

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32 FIPPA 2002 art 2  
33 ibid art 1  
35 FIPPA 2002 art 3  
36 ibid art 3(b)  
37 Iranian Constitution art 44
private sector is authorised. Foreign investment operations was impossible due to the fact that FIPPA did not cover investments in oil and gas and foreign investors had no incentive to make investments without FIPPA protections. The scope of activities of IOCs in the petroleum industries was restricted to formation of civil partnership, buyback and Build Operate Transfer schemes without equity ownership by foreign contractor (article 3(b) of FIPPA). The Law Amending Some Provisions of the Fourth Economic Development Plan and Implementing General Policies of Article 44 of the Constitution entitled the New Privatisation Act 2008 had removed the ambiguities surrounding the scope of activities in each economic sector (state, cooperative and private). The government is required to divest 80% of the share value in economic activities contained in article 44 of the Constitution to non-state actors by end of the Fourth Economic Plan. The sale of shares of state companies to non-state actors will be through public offerings in domestic or foreign stock exchanges and sale of shares to domestic and foreign markets through tenders. Under the Act, the government retains ownership and management of major industries including upstream oil and gas sector.

3.3 New Petroleum Act

The NIOC for the first time had concluded a joint venture agreement with Agip pursuant to the Iranian Petroleum Act 1957 which authorised the NIOC to enter into joint venture agreements with qualified IOCs through establishment of a “mixed organisation” (establishment of a mixed company with separate legal personality) and “joint structure” (formation of civil partnership without legal personality). The Petroleum Act 1976 excluded the joint venture model in upstream petroleum and replaced it with “service contracts.” Furthermore, the Petroleum Act 1987 banned any form of foreign investments in the oil and gas sector. The Act prohibited the granting of concession contracts and foreign investment in the petroleum resources. According to the Petroleum Act 1987, any foreign direct investment activity that entails ownership of resources, equipment and installations are prohibited and only “service contract” is authorised. Therefore, it could be concluded that the only method for securing foreign finance resources in the oil and gas sector was the “service contracts” and the only method for attracting foreign investment in the oil industry was the “buyback” method.

39 ibid
41 ibid
43 Petroleum Act 1976 art 6
44 Petroleum Act 1987 art 2
46 ibid 153
Subsequently, the above Petroleum Act was amended on 29 June 2011 (hereinafter called the New Petroleum Act). The New Petroleum Act defines oil contracts as bilateral or multilateral agreements concluded between the Ministry of Oil or any of its subsidiaries or between any operational units and one or more operation units or natural or legal persons inside or outside the country in accordance with the applicable laws, concerning the implementation of all or part of downstream and upstream petroleum or trading oil, petroleum products and petrochemical products. The New Petroleum Act authorises foreign investment by IOCs through formation of partnership agreements with local companies for upstream and downstream petroleum projects. The new definition covers both downstream and upstream activities and extends to trading oil, petroleum and petrochemical products.

3.4 Buyback scheme

After the revolution, the Iranian parliament in the Budget Act 1994 authorised the NIOC to sign contracts with maximum value of USD 3.2 billion with participation of foreign oil companies for the development of South Pars Gas Fields on the condition that the reimbursement of the entire costs of development be from the proceeds of the sale of products from the fields. The first buyback contract was signed between NIOC and the American company Conoco that was terminated due to sanctions by the Clinton administration. The NIOC and French oil company Total signed a buyback contract in 1995 to develop the South Pars Gas Field that was regarded at the time by industry experts as “paving the way for an oil development revolution”. According to statistics of Iran’s National Accounts which is published every year by the Iranian Central Bank (CBI), between 1997 and 2003, a total of 46 billion US dollars have been invested in the oil and gas sector from which amount, 19 billion dollars (equivalent to 41%) was through buyback and 11 billion dollars by securing financing arrangements. Buyback contracts are a form of risk service contracts in which the contractor funds all the field developments costs and recovers its costs together with fixed amount of remuneration, once it is established that there is a “commercially viable discovery”, from the petroleum produced from the field.

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47 Available at website of parliament: [http://rc.majlis.ir/fa/law/show/793088](http://rc.majlis.ir/fa/law/show/793088) accessed 02 Jan 2015 (Persian) (translation by author)
48 New Petroleum Act 2011 art 1(16)
50 ibid 220
practitioners and scholars have dissected the buyback contracts and described the legal nature of these agreements as complex and comprising multiple contracts with different conditions and effects. The buyback model has many deficiencies from the perspective of foreign contractor and the Iranian government. Contractors consider buyback contracts risky concerning the performance guarantees related to productions rates, development costs and project schedule and these risks are not compensated in the same manner as production sharing agreements (PSAs) through costs and profit oil mechanisms. The buyback contracts have key shortcoming including fixed rate of return (ROR), short duration of the contract regarded as unfavourable by some international oil companies (IOCs) and the terms are inflexible and do not provide a mechanism for renegotiation. Presently, there are two main issues underpinning the buyback contracts. First, assurance has to be given to the foreign oil company that once it has discovered a commercial oil field, it will enjoy the exclusive right to develop the field. Second, the proposal of IOCs concerning the development of the field after commercial discovery must be deemed feasible and accepted by the NIOC including the master development plan, capital cost ceiling, fixed remuneration fee, cost recovery period and other important issues. The above issues must be addressed in the new oil investment contracts to strike a balance between the expectations of IOCs and NIOC and to encourage and attract foreign investments in the petroleum industry. Oil major in the past had relied on the buyback to gain access to the Iranian energy market with the hope of negotiating more favourable terms with the NIOC at the post-establishment phase. Buyback contracts in the upstream oil and gas sectors have experienced

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54 These contracts include: a) contract for sale of equipment and technology, b) contract for licenses or assignment of patent rights to the host state, c) Contract for financing and funding projects, d) contract for insurance of equipment and installations, e) contract for payment of price of equipment and costs through delivery of products made from the same equipment, f) final protocol or written contract containing the entire agreement. B Akhlaghi and A Sahranavard, ‘Analysis of Legal Nature of Iranian Oil Buyback Contract and its Compatibility with the Energy Charter Treaty’ (2013) 43(3) Law Quarterly 1, 13 (Persian) (translation by author) 


56 From the perspective of the Iranian government, there are built-in deficiencies in buyback contracts: a) no price risk for contractor; b) fixed ROR; c) the life of the buyback project is short; d) only limited transfer of capital and technology; e) risk of incompliance with the Maximum Efficient Rate and doing damage to reservoirs; f) little to no motivation to cut down on expenses. M Kuhn and M Jannatfar, ‘Foreign Direct Investment Mechanism and Review of Iran’s Buy-back Contracts: How Far Has Iran Gone and How Far May it Go?’ (2012) J World Energy L and Business 1, 15 


58 ibid
three generations. The framework of the third generation buyback agreements conforms to provisions of article 14 of the Fourth Development Plan (see subsection 2.1).

3.5 Joint ventures

The NIOC concluded 12 joint venture agreements with IOCs, the first was the so-called SIRIP agreement, which was formed as a “mixed organization” and the rest were established as “joint structures”. Joint ventures are a suitable vehicle for structuring investment in the infrastructure and development projects by forming partnerships with local companies. Under the New Petroleum Act, foreign investors could sign joint venture agreements with Iranian companies for the exploration and development of oil and gas fields. There are no specific laws concerning formation and regulation of joint venture companies in Iran. The only piece of legislation containing provisions on regulation of joint venture, buyback and BOT contracts is the executive cabinet decree approved on 30 July 2003 concerning guarantees of non-commercial risks by the Iranian government. The joint venture agreements are generally divided into two categories the “equity joint ventures” and “contractual joint ventures”. The “equity joint ventures” are the common form of companies with participation of foreign investors in the equity capital of existing company or by establishing a new company in which the foreign investors and Iranian each hold a percentage of shareholding in the equity capital. The “equity joint ventures” may be structured as a Private Joint Stock Company (PJSC), a common type of commercial company in Iran. The “contractual joint ventures” are formed on the basis of agreement between the parties for implementing specific projects for a limited period of time.

4. New investment model

4.1 Committee for Oil Industry Contracts Revision (OICR)

As stated in previous subsection 3.4, terms of the buyback model are considered out-dated and deter IOC investments in Iranian oil and gas market. The new oil minister Bijan Zanganeh in August 2013 made an announcement concerning the establishment of an ad hoc committee for the revision of the oil investment contracts called the Oil Industry Contracts Revision (OICR) with the mandate to refine the existing buyback schemes to attract foreign investments. The third generation buyback agreements in the oil industry were launched in 2005 and currently there are few agreements in the upstream petroleum industry have been signed with international firms that are still in operational. The third generation agreements have been revised to remove inconsistencies in the former generations. The Committee for Oil Industry Contracts Revision (OICR) with the mandate to refine the existing buyback schemes to attract foreign investments.

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59 The third generation buyback agreements in the oil industry were launched in 2005 and currently there are few agreements in the upstream petroleum industry have been signed with international firms that are still in operational. The third generation agreements have been revised to remove inconsistencies in the former generations.

60 Cabinet Decree on Foreign Investment: the Regulation Governing Contracts concerning Civil Partnership, Buyback and BOT 2003


62 ‘Russia’s Interest to Invest in Iran’s Oil and Gas Fields’ (20 Jan 2014) Donyaye Eghtesad (Persian) (translation by author)
OICR was set up with the aim of creating a forum comprised of leading experts, lawyers and industry players and to organise conferences and seminars for discussions and analysis of different types of contracts. The OICR has launched a website (www.OICR.ir) containing information and materials in both English and Farsi. In an interview with a local newspaper, Mehdi Hosseini, the head of the OICR committee stated that, a new framework for oil contract would be designed to facilitate the use of know-how of oil majors and to increase the capacity of domestic companies.63 The Iranian President, Dr. Hassan Rohani and his oil Minister, in a closed-door meeting with executives of BP, Eni, Royal Dutch Sell and Total at the World Economic Forum held in Davos, Switzerland, told them to submit contracts that they would like Iran to adopt.64 In a two-day conference held in February 2014, the committee for the OICR had unveiled the New Model Iranian Petroleum Contract (IPC).65 The anatomy of the IPC resembles the Production Sharing Agreement therefore the author will discuss the main features of the PSA in the next subsection. According to the Oil Ministry, the new investment model is not the final version and local industry and foreign firms will be consulted before issuing the final draft of the oil contract.66

4.2 Production Sharing Agreements (PSAs)

The Minister of Oil had emphasised that the new investment model has the objective of achieving a win-win situation for both foreign investor and Iranian party. Meanwhile, according to comments of Iranian academics, PSAs make explicit references to mutual interests of both parties i.e.: the host government and contractor, which is why it is desirable for developing countries to sign PSAs and Iran as a developing country would gain many benefits from adopting PSAs.67 There is a no single definition of production sharing agreement. The PSA is an agreement signed between a contractor (a foreign oil company) and employer (a state company) under which the contractor is authorised to undertake operations concerning exploration and extraction of petroleum resources within a defined geographical area stipulated in the contract and oil and gas produced from the project will be divided between the contractor and state

63 ‘New Petroleum Agreements will be Private-sector Oriented’ (6 Jan 2014) Donyaye Eghtesad (Persian) (translation by author)
64 ‘Iran Courts Western Oil Majors at Davos’ (23 Jan 2014) Financial Times
65 The revision process included the reviewing of dissertations and research papers produced by scholars and comparing model oil contracts from thirty countries including the Iraqi Kurdistan.
66 President Rohani stated that, a new investment model for oil contracts would be ready by September and in the meantime a workshop will be held in London in the summer to discuss how the contracts would work. ‘Hassan Rouhani Outlines Plan for Iran’s Growth for Next Decade’ (23 Jan 2014) Financial Times
company. The entire operation stipulated in the contract must be on basis of approved annual budget plan and validity of the report containing executed plans are subject to the approval of the supervisory body which in most cases is the state company which awards the contracts. In case the exploration of the oil field leads to commercial discovery, the contractor is obligated to prepare a plan for development of the field and submit the same to the state oil company for their approval. The oil and gas which is produced will be divided at the “delivery point” between the state company or government and contractor but the point of transfer of ownership of the produced oil to the contractor will be specified on basis of the parties’ agreement contained in the contract. The contractor recovery of produced oil cover two parts: first, “cost oil” meaning a percentage of production will be allocated to the contractor for recouping the costs of exploration and production, so that in case of “commercial discovery” all costs of operation and implementation of contractor shall be reimbursed from the source of production. Second, the oil that probably remains following the deduction of the royalty, “cost oil” and income tax will be distributed between the contractor and state company within the framework of the contract. In this situation, the government contributes to the profits generated by the partnership, income tax and other earnings. The contractor is required to pay income tax after selling its shares; i.e. the income generated from selling “cost oil” and “profit oil” minus deductible expenses. The contractor is required to put aside part of the products to compensate costs of operation and development and divide the remaining balance with the state company on the basis of an agreed formula.

4.3 Iranian Petroleum Contract (IPC)

The Iranian Petroleum Contract (IPC) offers IOCs more attractive and acceptable terms and condition for exploration and production (E&P) of oil and gas field operations. The purpose of the IPC is to attract foreign investment for the development of existing and newly discovered oil fields in accordance with international standards and practises at the lowest costs possible, maximum efficient rates, highest recovery factor for the whole life cycle. The new investment model facilitates transfer of technology to the Iranian companies and localising the know-how and management skills by making partnership with local companies and maximum employment of local experts. The new oil investment contract offers foreign investors an opportunity to form partnerships with Iranian companies for exploration and development of oil and gas

68 M Amani and M Shafizadeh Kholanjani, ‘Compatibility of Structure of Production Sharing Agreements with the Requirements of National Sovereignty and Ownership over Oil Deposits’ (2012) 19(72) Majlis and Rahbord Quarterly 141, 147 (Persian) (Translation by author)
69 Ibid 148
70 Ibid
71 Ibid
72 Ibid
74 IPC art 2
75 Ibid
resources. The “partnership model” covers three stages of exploration, development and production. During exploration phase, the IOC as the sole operator is fully responsible for all risks and costs of operation and the NIOC may participate in the operation as the technical partner under the leadership and responsibility of the IOC.\textsuperscript{76} In the development and production stages, the parties may establish a joint venture (Joint Development Company) as a vehicle for technical and financial support required for production as well as capacity maintenance and subsequent integrated oil recoveries (IOR) or enhanced oil recoveries (EOR) operations.\textsuperscript{77} At the production stage, the parties may establish a non-profit joint operating company consisting of the IOC and the NIOC affiliates from the production operation divisions.\textsuperscript{78} The JVC established during the Development Period will provide technical and financial support to this joint operating company for further field development, capacity maintenance as well as IOR/EOR operations. From a legal point of view, partnership through establishment of a joint venture company (JVC) means that an independent company with a separate legal personality can sign contract with the host government and as an Iranian company engage in implementation of exploration and extraction operations.\textsuperscript{79} Iranian scholars have highlighted the importance of fiscal regime for distribution of income generated from upstream oil and gas operations including corporate tax, bonuses, leasehold rent, royalty fees and special oil tax.\textsuperscript{80} The distribution of profits between shareholders could be in the form of actual oil and gas to be divided between the host government and the foreign partner in proportion to their respective shareholdings in the joint venture company.\textsuperscript{81} Therefore, IOCs and Iranian companies could make joint investments in particular oil field for the purpose of sharing of production pursuant to the provisions of the agreement. The new investment model for oil contracts envisage participation of both foreign investors and Iranian private sector in the development and production of petroleum on the basis of 49-51% foreign-Iranian shareholdings. Therefore, the foreign investor is required to purchase 51% of tools, equipment and services supplied by domestic manufacturers in conformity with the local content laws.

4.4 Supreme Board of Supervision over Petroleum Resources

The New Petroleum Act 2011 stipulates that all petroleum resources are public wealth (\textit{anfal}) and exercising right of sovereignty and public ownership over the resources is the responsibility of Ministry of Oil as representative of Islamic Republic of Iran.\textsuperscript{82} The Supreme Board of

\textsuperscript{76} ibid art 4  
\textsuperscript{77} ibid  
\textsuperscript{78} ibid  
\textsuperscript{79} F Iranpour, ‘Various Types of Petroleum Contracts: Transformation of Oil Contracts from Buyback Contracts to Production Sharing Agreements’ (2008) 38(2) Legal Periodicals 25, 36 (Persian) (translated by author)  
\textsuperscript{80} M Amirmoeini, ‘Application of Fiscal Instruments in Oil and Gas Contracts: a Model for Iran’ (2005) 3(8) Energy Economic Observation Quarterly 91, 121-122 (Persian) (Translation by author)  
\textsuperscript{81} ibid  
\textsuperscript{82} New Petroleum Act 2011 art 2
Supervision over Petroleum Resources will be established in accordance with this law to monitor the exercise of right of sovereignty and public ownership comprising of the following:

1) Oil Minister as the Secretary of the Board
2) The President’s Deputy for Planning and Administration
3) Minister of Economic Affairs and Finance
4) The President of the Central of Bank of Islamic Republic of Iran
5) Head of the Energy Commission of the Parliament
6) Head of the Planning and Budget Commission and Auditing Commission of Parliament
7) Chief State Prosecutor
8) Two persons to be nominated by Oil Minister from deputies of the Ministry of Oil.  

5. International sound FDI legal system

5.1 Common Denominator Paradigm

International investment law is a fast growing field of international law that has evolved through the proliferation of bilateral investment treaties BITs and jurisprudence of arbitral tribunals. BITs contain common denominators of free admission, fair treatment, compensable expropriation and access to international arbitration, which are the building blocks for structuring an “international sound legal system” for foreign direct investment. The common denominators are universally accepted standards of investment protection under the principles of customary international law therefore legal principles should be extracted from contents of the BIT law to develop an investment friendly regime. The Iran-US Claims Tribunal is the first modern investment tribunal set up in The Hague under the Algiers Accord 1981 between Iran and the United States to settle their disputes following the Iranian Revolution 1979. The jurisprudence

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83 ibid art 3
84 For more details on international standards see A Reinisch (ed), Standards of Investment Protection (Oxford University Press, Oxford 2008)
85 The author developed the concept of common denominators in international investment law in his PhD thesis which was termed as the “Common Denominator Paradigm”, A Atai, Investment Protection Standards under International Law and Iranian Law: A Case for Reform of the Iranian Foreign Investment Promotion and Protection Act 2002 (PhD dissertation, University of London 2011) 109
of the Iran-US CT has made a great contribution to the evolution of international law in general and investment law in particular. The wealth of literature produced by the awards of the Iran-US Claims Tribunal had a great impact on the formulation of many international investment instruments such as the World Bank Guidelines on investment and NAFTA Chapter 11 on investment. The case law generated by the Iran-US CT has established customary international law principles concerning state responsibility, indirect expropriation, nationality test and standards of compensation. ICSID and other institutional and ad hoc arbitral tribunals have relied on the jurisprudence of the Iran-US CT as authoritative statement of international investment law. International investment agreement (IIAs) including Iranian BITs incorporate the principles established by case law of the Iran-US CT concerning protection against indirect expropriation and the requirement for payment of “prompt, adequate and effective” compensation. The application and interpretation of investment protection standards depend on the text of the BIT, rules of procedure of arbitral tribunal and applicable substantive law. A typical investor-state arbitration clause in modern BIT is replication of the Claims Settlement Agreement (CSA) signed between Iran and the US under the Algiers Accord to settle claims of their nationals against contracting states parties. Iran has signed more than 100 BITs (51 BITs are in force) with capital-exporting and neighbouring countries to encourage and attract foreign investments. Iranian BITs guarantee foreign investor fair and equitable treatment standard (FET), national treatment, most favoured nation treatment (MFN), monetary transfer, compensation for expropriation, observation of commitments (umbrella clause) and access to international arbitration. The principles covered by the fair and equitable treatment are transparency and protection of the investor’s legitimate expectation, freedom from coercion and harassment, procedural propriety and due process, and good faith. A subset of the principle of due process and natural justice includes administrative decision-making and procedural fairness. Iran

88 (After more than 25 years the tribunal still has not completed work and has not yet ruled on key claims of the Iranian government. But the vast majority of 3,800 claims, often involving complex factual and legal matters have been decided.) R Dolzer and C Schreuer, Principles of International Investment Law (OUP, Oxford 2008) 229
89 North America Free Trade Agreement
90 International Centre for Settlement of Investment Disputes
92 ibid
93 According to information provided by The Organization for Investment, Economic and Technical Assistance of Iran (OIIETAI) there are 51 BITs in force, 12 BITs signed, 7 BITs approved, 8 BITs negotiated, 48 BITs have been exchanged with partners which come to a total figure of 126 BITs. Available at www.oietai.ir accessed 02 January 2015
94 For comprehensive analysis of Iranian BITs see generally A Atai, ‘Iranian Bilateral Investment Treaties: Substantive Principles and Standards’ (2013) 14 J World Investment and Trade 397
95 For more details see C Schreuer, ‘Fair and Equitable Treatment in Arbitral Practice’ (2005) 6(3) J World Investment and Trade 357, 373-358
adopted its first Model BIT\(^97\) in 2001 containing the policies of the Iranian government concerning treatment of foreign investment. The Iranian BITs condition the application of above mentioned substantive investment protection standards to registration and approved of investment by the Organisation for Investment, Economic and Technical Assistance of Iran (OIE). Therefore, foreign investors must obtain an investment licence to benefits from BIT protection including access to investor-state arbitration (see section 5.3).

5.2 Investment friendly regime

In previous sections the author outlined the framework for foreign investments including the new model for investments in the Iranian energy resources. There are different theories concerning the criteria for an ideal legal system for foreign direct investment. The proponents of the “dominant theory” developed by the Perry-Kessaris Paradigm articulate that foreign investors are attracted to a location with a “sound legal system.”\(^98\) An effective and efficient legal system is characterised by the quality of laws and institutions that determines investor’s decision to choose or not to choose a particular location for foreign direct investment.\(^99\) In an ideal legal system, laws are accessible, modern and stable and there is an independent, impartial judiciary for the enforcement of laws.\(^100\) A rule-based legal system provides a level playing field in which economic actors engage in commercial transactions for the exchange of goods and services.\(^101\) A “sound legal system” recognises ownership and contractual rights and guarantees financial damages to the aggrieved party in case of default by other party.\(^102\) A legal system that upholds the rule of law is fundamental for a fully functioning market economy. However, countries with abundant natural resources and mineral wealth may not have mature legal system. Investors allocate capital funds to the host state to make profits and return on its investment. Therefore, there are elements of risk and reward involved in foreign investment operations. Foreign investor develops the host state economy with the expectation of generating income once the investment is realised. The main concern for foreign investors undertaking large and capital-intensive infrastructure and turnkey projects are the stability of the legal system and protection against political risks of expropriation and currency inconvertibility. Resource-rich countries offer incentives, guarantees and privileges to encourage and attract international investments. The national investment law incorporate common principles and standards of investment protection recognised under international law including: a) admission and establishment; b) fair and


\(^{98}\) For more detail see A Perry, Legal System as Determinant of Foreign Direct Investment: The Case of Sri Lanka (Kluwer Law International, The Hague 2001)

\(^{99}\) A Perry, ‘Effective Legal System as a Determinant of Foreign Direct Investment: in Search of the Evidence’ (2000a) 49 ICLQ 779

\(^{100}\) A Perry, ‘An Ideal Legal System for Attracting Foreign Direct Investment? Some Theories and Reality’ (2000b) 15 American University Intl Rev 1627

\(^{101}\) A Atai, ‘Fair and Equitable Treatment of Islamic Investments in Qatar’ (15 May 2013) Vol. 10 Issue 19 Islamic Finance News 20

\(^{102}\) ibid
equitable treatment; c) expropriation standard and compensation; and, d) access to international arbitration, which are the core components of an investment friendly regime. The Iranian Foreign Investment Promotion and Protection Act 2002 (FIPPA)\textsuperscript{103} is equivalent to a BIT and contains important provisions concerning principles of national treatment and currency transfer rights.\textsuperscript{104} Despite similarities between FIPPA and its BIT counterparts, there are divergences concerning expropriation standard and dispute resolution procedure.\textsuperscript{105} To resolve the problem, provisions of FIPPA should be amended to become compatible with the international law standards.\textsuperscript{106} In May 2003, Iran acceded to Convention Establishment the Multilateral Investment Guarantee Agency (MIGA) that came to force in 1988.\textsuperscript{107} Therefore, foreign investors could obtain insurance guarantee against political and non-commercial risks of expropriation, currency transfer, breach of contract and war and civil disturbances.\textsuperscript{108}

5.3 Investor-state dispute settlement (ISDS)

Foreign investors do not have equal bargaining power as the host state party in an investment contract and the host government may abuse its sovereign powers and enact measures concerning unlawful expropriation, unilateral termination of contract, alteration of contractual terms and cancelation or non-renewal of licenses and permits.\textsuperscript{109} Furthermore, national courts may be sympathetic to the public policy and welfare objectives of the host government and reluctant to condemn state measures enacted for the protection of health and safety of its citizens and protection of the environment. Investor-state arbitration provision in BITs guarantee an independent, neutral and third-party arbitral tribunal outside the host state jurisdiction with the power to determine whether or not the host state government has breached its international law obligations under the applicable treaty and award aggrieved investor financial damages for incurred losses. Dispute resolution provision in BITs offer investors the right to refer their disputes with the host state government to arbitral tribunal constituted in accordance with ICSID arbitration rules, ICC arbitration rules, \textit{ad hoc} arbitration rules of UNCTAD and agreement of parties regarding the arbitration procedure. Iran has not ratified the Convention on Settlement of Investment Disputes between States and Nationals of Other States adopted on 14 October 1966 (ICSID/Washington Convention).\textsuperscript{110} However, notwithstanding the non-ratification of ICSID

\textsuperscript{103} For detailed review of FIPPA provisions generally see A Atai, ‘Comparative Analysis of the Iranian Foreign Investment Law and the World Bank Guidelines on the Treatment of Foreign Direct Investment (2005-2006) Yearbook of Middle Eastern and Islamic Law

\textsuperscript{104} A Atai, ‘Iranian Bilateral Investment Treaties: Substantive Principles and Standards’ (2013) 14 J World Investment and Trade 397, 433

\textsuperscript{105} ibid

\textsuperscript{106} ibid

\textsuperscript{107} Ardeshir Atai, ‘Standards of Treatment of Foreign Investments in Iran’ (2009) Company Lawyer 347, 350

\textsuperscript{108} ibid


\textsuperscript{110} For detailed analysis of dispute resolution under Iranian BITs see generally A Atai, ‘Arbitration of Investment Disputes under Iranian Investment Treaties’ (2011) 14(2) J Money Laundering Control 130
Convention by Iran, treaties signed with Austria, Croatia, France, Finland, Greece, Italy, Malaysia, Spain and South Korea refer to ICSID arbitration as an option for settlement of investment disputes. In case, one of the contracting parties has acceded to the ICSID Convention, the foreign investor may refer the dispute concerning an investment to a tribunal constituted in accordance with ICSID Additional Facility Rules. If none of the parties have ratified the ICSID Convention, neither ICSID Arbitration Rules nor Additional Facility Rules is applicable and the parties may evoke ad hoc Arbitration Rules of UNCITRAL. In 2009, a Turkish telecom company Turkcell brought the first BIT claim against Iran under the Iran-Turkey investment treaty by alleging illegal expropriation of its investment by the Iranian government and denial of fair and equitable treatment, full legal protection and most-favoured-nation treatment standard. The dispute arose from a tender process for the second mobile phone operator in which Turkcell was announced as the winner of the tender in 2004 but shortly after the Ministry of Communication assigned the project to another operator. The tribunal applied the UNCITRAL Arbitration Rules and held that it had no jurisdiction to hear claims worth US$ 600 million brought by Turckell and secondly, the contractual rights claimed by Turkcell was not a qualifying investment under the treaty. On 15 October 2014 the tribunal issued an award ordering Turkcell to reimburse Iran the sum of US$1.5 million for costs of arbitration proceedings. The claimant investor must meet the condition precedents before invoking investor-state arbitration under the investment treaty. These are the requirements for negotiation and conciliation, waiting period and time limitation, notification of claim, and waiver of local law remedies. The scope of dispute resolution provision in investment treaties covers “any” dispute concerning investments between a contracting party and foreign investors be submitted to international arbitration. Investment treaties define investment as any kind of asset, invested directly and/or indirectly by the investors and the list of assets includes inter alia rights to search for, extract or exploit natural resources. Iranian Model BIT protects any type of investment encompassing rights to search for, extract or exploit natural resources. Therefore, contracts for the exploration and development of oil and gas resources could qualify as investments and benefit from BIT protections including access to international arbitration. As a pre-condition for instituting arbitration proceedings under the investment protection treaty, the investor must satisfy the jurisdictional requirements contained in provisions concerning: a) definitions (investment and investor); b) investor-state dispute resolution; c) scope of application/agreement (investment license); and, d) observation of commitments (umbrella clause). In addition the claim must be founded on the violation of international law obligations under the investment

112 ibid
113 ibid
115 Germany BIT art 1
116 Iranian Model BIT art 1(1)
treaty (frustration of investor’s legitimate expectation and unlawful expropriation of investment) and be attributed to the host government.

6. Arbitrating oil and gas disputes

The preceding sections critically analysed the substantive framework concerning foreign investment in the hydrocarbon resources. This section examines the procedural rights of foreign investors. Iran has participated in a series of arbitration proceedings relating to oil and gas disputes. In 2014 a tribunal in The Hague issued an award concerning a dispute arising out of a 25-year contract for the supply of gas by the National Iranian Oil Company (NIOC) to the United Arab Emirates. In December 2014 an ICC tribunal dismissed the Turkish state entity’s claim for a price cut valued at US$13 billion arising out of a contract for the export of gas by Iran to Turkey. In December 2014, following a 20-year long arbitration case, a tribunal in Geneva ordered Israel to pay Iran US$100 million for a dispute concerning a joint venture agreement signed between Iran and Israel before the Revolution for construction of a pipeline connecting the Eilat port in the Red Sea to the port of Ashkelon in the Mediterranean Sea to export Iranian oil to world markets following the closure of the Suez Canal. There are specific laws Iranian laws governing arbitration of oil and gas disputes. The Law concerning Exploration and Exploitation and Extraction of Oil in the Entire Country and Continental Shelf\textsuperscript{117} 1957 and the Law of Development of Petrochemical Industries\textsuperscript{118} 1965 authorise the NIOC and National Petrochemical Company (NPC) respectively to refer disputes with contracting parties to arbitration.

6.1 Civil Procedure Code

According to the Civil Procedure Code (CPC), all persons with capacity to file law suit may with mutual consent of other party refer his dispute to arbitration irrespective of whether or not the case has been referred to the courts of law and in case the court is deciding the case, at any stage of proceeding the parties may agree to submit the case to arbitration.\textsuperscript{119} The Civil Procedure Code restricts the Iranian party from appointing an arbitrator or arbitrators with the same

\textsuperscript{117} Law concerning Exploration and Exploitation and Extraction of Oil in the Entire Country and Continental Shelf 1957 art 14 states that, differences arising between the National Iranian Oil Company and parties if not settled through amicable negotiations as stipulated in each contract shall be resolved through conciliation and arbitration. The rules relating to referral of disputes to conciliation and arbitration shall be specified in each contract.

\textsuperscript{118} Law of Development of Petrochemical Industries 1965 art 5 states that, differences arising between National Petrochemical Industries Company and other parties if not settled through amicable negotiations envisaged in each contract shall be settled through conciliation and arbitration. The rules of procedure concerning submission of disputes to conciliation and arbitration shall be specified in each contract.

\textsuperscript{119} Iranian Civil Procedure Code art 455
nationality as the contracting party. The CPC envisage only *ad hoc* arbitration and does not refer to institutional arbitration. If one party fails to appoint arbitrator the other may appoint his arbitrator and inform the other party by sending a notice and request him to choose his arbitrator within ten days and in case of non-compliance he may refer to the court for appointment of arbitrator(s).

6.2 FIPPA dispute resolution provision

The dispute resolution provision in the Iranian investment law (FIPPA) requires the investor to, first settle disputes concerning investments with the Iranian government through negotiations failing which the investor may refer the dispute to the Iranian courts. The second part of the above provision continues by stating that in case there is an investment treaty between government of Iran and home state of investor containing investor-state dispute settlement (ISDS), the investor may choose alternative dispute resolution procedure. Although there is no express reference to arbitration, the dispute resolution provision in FIPPA indirectly offers investors the option to refer their disputes to arbitration provided that there is an applicable BIT.

6.3 Law of International Commercial Arbitration (LICA)

In 1997 the parliament passed the Law of International Commercial Arbitration (LICA) to create favourable environment for foreign investment. The LICA is largely based on the UNCITRAL Model Law on “International Commercial Arbitration” which is an important step towards harmonisation of Iranian arbitration law and practice with international standards and procedures. Main features of LICA include recognition of party autonomy by granting the contracting parties the right to appoint arbitrators, select the applicable law, and choose the location and language of arbitration proceedings. Other benefits of arbitration under the LICA provisions include non-intervention of Iranian courts in the proceedings, recognition and enforcement of the arbitral awards, competence of the arbitral tribunal to determine its own jurisdiction, power of the arbitral tribunal to take provisional measures, appointment of experts, and the requirement for equal treatment of the parties by the tribunal which is fundamental for due process and natural justice. A major development in the Iranian arbitration practice is that for the first time LICA has recognized the concept of institutional arbitration, therefore the contracting parties may choose arbitral institution such as the International Chamber of Commerce (ICC), London Court of International Arbitration (LCIA) or German Institution of Arbitration (DIS) for supervision and administration of arbitration proceedings. The scope of

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120 ibid art 456
121 ibid art 459
122 FIPPA 2002 art 19: Any disputes between the government and foreign investors related to the investments subject of this Act which can not be settled through negotiations, shall be examined by domestic courts of law, unless another mode of settlement of disputes has been agreed upon within a law on bilateral investment agreement with the government of the Foreign Investor.
issues to be resolved through “international commercial arbitration” includes sales of goods or services, transportation, insurance, fiscal matters, consulting, investment, technical cooperation, representation, factoring, construction of works and other similar activities.\(^{124}\) Therefore, the scope of application of LICA is broad and may extend to petroleum extraction and exploration projects.

6.4 Article 139 of the Constitution

The Iranian Constitution requires the approval of parliament for arbitration of disputes relating to public and state assets where one party to the dispute is a foreign national.\(^{125}\) According LICA, the provisions of the Act shall not affect any other law of the Islamic Republic of Iran by virtue of which certain disputes may not be submitted to arbitration.\(^{126}\) A question arises as to whether an arbitration agreement between a foreign investor and the Iranian government or state entity (i.e. NIOC) containing arbitration clause satisfies the requirement for consent. LICA conditions the submission of disputes to arbitration on consent of both contracting parties.\(^{127}\) Therefore, it is imperative that the contracting parties expressly consent to the arbitration in the arbitration agreement/clause otherwise the arbitral tribunal will decline jurisdiction. According to Iranian commentators, article 139 of the Constitution requires the approval of the parliament concerning arbitration of disputes relating to public and state assets in cases involving foreign nationals and there is an indication that disputes between the government and foreign investors concerning contractual obligations could be referred to arbitration [without the parliament’s approval].\(^{128}\) The LICA does not specify the types of disputes that cannot be referred to arbitration and makes no reference to article 139 of the Constitution.\(^{129}\) A question arises as to whether parliament’s ratification of a treaty containing investor-state arbitration clause satisfies the requirement for approval pursuant to article 139 of the constitution law. Article 77 of the Constitution requires the parliament to approve international treaties signed by the government.\(^{130}\) Therefore, once the parliament ratifies an investment treaty, and dispute arises between the parties there is no need

\(^{124}\) LICA 1997 art 2(1)

\(^{125}\) Iranian Constitution art 139 states that: settlement of disputes concerning public and state property or their referral to arbitration in every instance, is subject to approval of the Cabinet of Ministers and must be informed to the parliament. In cases where one party is foreign national and in important domestic cases the approval of the parliament is also required. Important cases shall be specified by the law.

\(^{126}\) LICA 1997 art 36(2)

\(^{127}\) Art 2(2) LICA states that, ‘All persons who have the capacity to exercise their right to institute a lawsuit, may with “mutual consent” and in accordance with this Law submit their international commercial disputes to arbitration …’

\(^{128}\) L Zabbah, ‘Legal Challenges for Foreign Investment in the Iranian Oil and Gas Sector’ (2008) 1 Reviewing Energy Economic Matters 137, 145 (Persian) (translation by author)

\(^{129}\) Art 496 of the Iranian Civil Procedure Code prohibits arbitration of claims relating to bankruptcy, and claims relating to validity and annulment of marriage, divorce and custody.

\(^{130}\) Iranian Constitution art 77 states that, international treaties, protocols, contracts, and agreements must be approved by the Islamic Consultative Assembly.
for a separate approval.\footnote{A Atai, ‘Iranian Bilateral Investment Treaties: Substantive Principles and Standards’ (2013) 14 J World Investment and Trade 397, 425} In case a BIT contains an unconditional offer of consent to the foreign investor and the Iranian parliament ratifies the treaty without making any reservations, then the application of article 139 of the Constitutional does not pose as an obstacle for initiation of arbitration proceedings by the foreign investor.\footnote{A Atai, ‘Arbitration of Investment Disputes under Iranian Investment Treaties’ (2011) 14(2) J Money Laundering Control 130, 134} As a measure of protection, the arbitration agreement between the parties may specify that, the Iranian state party has already complied with provisions of article 139 of the constitution law or obtained necessary authorization in respect of the arbitration clause. The foreign investor may also request the state entity to issue a letter of undertaking or a side-letter containing confirmation that it has authority to sign contract containing arbitration clause.\footnote{ibid 150 [footnote 36]}

6.5 Dispute resolution provision in the new oil contract

The new model Iranian Petroleum Contract (IPC) offers the contracting parties the option to resolve their disputes through amicable negotiations, expert determination and arbitration. Article 13 of IPC entitled settlement of disputes requires the parties to settle their differences and disputes in good faith and amicably.\footnote{Article 13(a) of the Iranian Petroleum Contract states that, In case the parties cannot find an amicable settlement in spite using all their efforts and good intention they are recommended to refer the case to independent expert or arbitration for adjudication. Expert determination covers cases where the disputes concern technical, financial or interpretation of contract in which case the parties will agree on professional company, firm or individual expert to review the subject matter and issue a binding award} The arbitration clause in the IPC offers the contracting parties the option to refer their disputes to an independent and internationally recognised court for a binding award.\footnote{IPC art 13(b)} The draft new model oil contract does not contain a choice of law clause. According to the Iranian Civil Code, the governing law of the contract is the law of place of performance of contract unless both parties are foreign nationals and have designated law of another country as the governing law of contract.\footnote{Iranian Civil Code art 968} Where the place of performance and signing of the contract is Iran, the governing law of the contract will be Iranian law and Iranian nationals cannot select foreign law as the governing law. LICA recognises the choice of foreign law as the applicable law of the contract.\footnote{LICA art 27 provides that, ‘the arbitrator shall decide the dispute in accordance with such rules of law as are chosen by the parties as applicable to the substance of the dispute. Designation of the law or legal system of a given State, in any manner whatsoever shall be construed as referring to the substantive law of that State. The conflict of law rules shall not be covered by this designation, unless the parties have agreed otherwise.’} Therefore, the contracting parties when negotiating the terms of the contract may select foreign law and arbitral institutions as the governing law and jurisdiction of the contract.
6.6 Arbitration institutions
As mentioned in the subsection 6.3, the adoption of LICA has laid the foundation for recognition of international arbitration. There are three main arbitration institutions in Iran, the arbitration centre of the Iranian Bar Association, arbitration centre of the Iranian Chamber of Commerce and Tehran Regional Arbitration Centre (TRAC). The TRAC was established on the basis of the agreement between the Iranian government and the Asian-African Legal Consultative Organization (AALCO) in 1997. The responsibilities of TRAC are as follows:

1) The promotion of international commercial arbitration in the region.
2) The co-ordination of the activities of, and assistance to, existing arbitration institution in the region.
3) Assistance to *ad hoc* arbitrations in cases where they are taking place in accordance with the UNCITRAL Rules.
4) Assistance with the enforcement of arbitral awards.
5) Conducting arbitrations under the auspices of the TRAC.

The TRAC has adopted and modified the Arbitration Rules of UNCITRAL as the rules of procedure. Therefore, contracting parties in an oil investment contract may choose TRAC as the dispute resolution forum and TRAC Arbitration Rules as the applicable rules of procedure. The easing of sanctions and flow of foreign investment will have an impact on the status of TRAC as a regional arbitration institution and facilitate and support arbitration proceedings between foreign investors and Iranian parties.

7. Enforcement of international arbitration awards

7.1 United Nations Convention on Recognition and Enforcement of Foreign Arbitral Awards (NYC)
In 2001, Iran ratified the United Nations Convention on Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention) 1958. The accession to the NYC has paved the way for foreign investors to refer their disputes to international arbitration outside of Iran. The New York Convention applies to arbitration awards that are rendered in a country other than the

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139 M Mashkour, ‘Building a Friendly Environment for International Arbitration in Iran’ (2000) 17(2) JIA 79, 80
country where recognition and enforcement is sought (art 1(1) NYC). The contract between the foreign investor and the Iranian government or state entity should stipulate in the “foreign arbitration clause” that, disputes between the parties shall be submitted to international arbitration to be held in a foreign jurisdiction. The “foreign arbitration clause” in the contract serves two purposes. First, it prevents the Iranian court from exercising jurisdiction over the claim by making clear that the intention of parties is to refer all their disputes to international arbitration outside of Iran (art 2(3) NYC). Secondly, the written agreement between the parties to submit disputes to arbitration satisfies the jurisdictional requirement under article 2(2) of NYC. As to the question of which country will be the most suitable place for arbitrating investment disputes, two important issues become relevant: a) annulment and set-aside; and, b) recognition and enforcement of the award.

7.2 Annulment and setting-aside the award

The losing party can challenge the enforcement of the award in Iranian courts on the basis of any of the grounds for annulment and setting-aside specified under article 5 of the NYC. The grounds for annulment and setting aside of the arbitral award are as follows:

a) The parties were under an incapacity or the arbitration agreement is invalid;
b) The losing party was not given proper notice of the appointment of arbitrator(s) or the arbitration process or was otherwise unable to present his case;
c) The award deals with a dispute not falling within the agreement to submit to arbitration;
d) The composition of the arbitral authority or the arbitral procedure was not in accordance with the agreement of the parties or the laws of the country in which arbitration was conducted; or

e) The award has not yet become binding on the parties or has been set aside or suspended by the law or a competent authority of the country in which the award was made.

The Iranian court can refuse recognition and enforcement of the arbitration award if there are procedural irregularities in the arbitration proceedings as stated above. Furthermore, under article 5(2) NYC, the Iranian court must determine whether or not the subject matter of dispute can be settled through arbitration, and the recognition and enforcement of arbitration award is not contrary to the public policy. The national arbitration law of the place of arbitration normally governs the challenging of the arbitral award. Therefore, the losing party may apply to the national courts of the country in which the award was issued to set-aside the award on the basis of the grounds set out in the national arbitration statute. In such a case the Iranian court may

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142 For example, where the arbitration proceedings are conducted in a contracting state such as Switzerland, then the Swiss award will qualify as a foreign award for the purpose of New York Convention, notwithstanding the choice of Iranian law as the governing law of the contract or arbitration rules of ICC rules as the rules of procedure.
refuse recognition and enforcement of an award that has been annulled in country of origin pursuant to article 5(1)(e) of the New York Convention. The foreign investor must choose a country whose arbitration legislation contains limited grounds (i.e.: procedural irregularities and public policy) for annulment and setting-aside of the award such as those that have adopted the UNCITRAL Model Law on “International Commercial Arbitration” or some variant of it.

7.3 Reservations attached to the New York Convention
The post-award stage involve (i) the confirmation or exequatur proceedings at the situs of the arbitration, (ii) the proceedings to enforce the award in a jurisdiction other than the situs, and (iii) the proceedings to execute by seizure of the respondent’s assets, either at the situs or other jurisdiction where asset can be found. A different law govern each of the three types of proceedings: confirmation is governed by the lex arbitri of the situs; the New York Convention will apply to the enforcement in non-situs jurisdiction, as adopted and modified by the national law and, execution is governed exclusively by the national law of the forum where the assets are located. Iran has attached reservations to the Law Ratifying the NYC 2001 as follows:

1. The legal contractual relationship of the parties should be considered commercial under the Iranian law,
2. The provisions of Convention shall be implemented on the basis of reciprocal relationships and the awards which are issued in the jurisdiction of the contracting states can be recognised and enforced;
3. Compliance with article 139 of the Constitution concerning arbitration of government disputes.

Once the claimant investor obtains a favourable award from the international tribunal, it must submit the documents required under article 4 of NYC to the Iranian courts together with the request for the recognition and enforcement of the arbitration award. The award will be binding on the parties and recognised according to the rules of procedure. The Iranian court will first establish whether or not the arbitration award under the Iranian law governs commercial relationship and the issuing tribunal is situated in a NYC country. After assessing and making sure that the award meets the above requirements, the Iranian court will issue an enforcement order and the arbitration award will be enforced under the same rules of procedures required for enforcement of the judgments rendered by the Iranian court. In conclusion, the enforcement of the foreign award in Iran is possible provided that the award issued by an international tribunal does not fall under any of the categories for refusal of recognition and enforcement.

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143 The applicant should send an application to the Iranian court requesting recognition and enforcement of the foreign award together with the original award and the arbitration agreement (art 4 NYC).
144 NYC art 3
146 ibid
enforcement of the award as specified by article 5 of the New York Convention. So long as the choice of foreign jurisdiction is a contracting state to the New York Convention, and provided that the dispute arises out of a commercial relationship (art 1(3) NYC), the arbitration award will be recognised and enforced by the Iranian courts.

Conclusion

The regulatory environment concerning energy investment has undergone major changes and the Iranian government has initiated a series of measures for the liberalisation of the upstream and downstream petroleum. The energy reform policies cover development of shared oil and gas fields, construction of new refineries and private public partnerships (PPP). The main features of the new model oil contract include flexibility and transparency of terms, integrated exploration, exploitation and production stages and innovative tools for leveraging risks and costs of investments. International energy investment law is evolving through proliferation of investment treaties and jurisprudence of arbitral tribunals that has transformed legal systems. The combination of international law and municipal laws in investment protection treaties has unified the common themes concerning admission, treatment, expropriation and compensation standards and investor-state dispute settlement system. The new paradigm for attracting foreign investment emphasises on an “internationally sound legal system” characterised by free market access, fair treatment of investments, fair compensation for expropriation of investment and access to international arbitration. These are the core components of an “investment friendly regime.” Resource-rich countries without developed legal system should harmonise their investment laws to attract international capital investments. The dispute resolution provision in petroleum investment contracts could be based on the investor-state dispute settlement system in BITs containing rules and procedures; notice of dispute/request for arbitration, constitution of arbitral tribunal, consent to arbitration, applicable substantive law, language and place of arbitration, waiver of sovereign immunity, non-intervention of courts and enforcement of arbitral awards. The Iranian arbitration law offers a two-tier system; domestic and international arbitration that is a shortcoming. Furthermore, arbitration of oil and gas disputes involves application of rules and regulations that are scattered, uncoordinated and repetitive. A single Arbitration Act should be adopted to contain uniform rules and procedures concerning arbitration of commercial and investment disputes including both domestic and international arbitration. In the context of the nuclear negotiations, a final nuclear deal that removes comprehensive sanctions against Iran must be agreed. Such a deal will be a win-win for both parties as multinational companies will invest and develop the Iranian energy resources and Iran can resume export of its petroleum to global markets. The nuclear deal will have significant impact on peace and security in the war-torn region and facilitate cooperate between Iran and the Western powers in the fields of peace, security and trade on the basis of reciprocity, trust and mutual respect.