

Analysing the Legal Framework of Petroleum Production in Iran, Past and Present

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Abstract

Considering the imperativeness of oil to economic development and the complexity involved in its production, contract involving state and International Oil Companies (IOCs) is not considered a simple contract. This makes the legal framework of oil production imperative. The main thrust of this article is to highlight the essential features of the various legislation and contractual arrangements which make up the legal framework. These were examined from a host state perspective. The enactments and contractual modes considered relevant issues such as ownership and control of petroleum. The study adopted doctrinal method. It revealed that Iran has undergone changes in their legislation and contractual modes to enable it control and sustain the oil industry. And that domestic law pervades the petroleum contracts in Iran. Furthermore, that Iran's approach to oil contracts is not liberal and the issue of the law applicable has never been resolved satisfactorily. There is the overbearing influence of state on contracts. Also, disclosed the legal obstacles inherent in these laws and contractual arrangements. It recommends that constitutional amendment be undertaken to accommodate the interest of IOCs, adopt Petroleum Sharing Agreement (PSA) as a viable alternative to Buyback and Iran petroleum Contract (IPC). Iran should reinvent its political strategies and foreign policy towards America. It concludes that there is much state involvement in the oil contracts. Interest of IOCs is not protected after investing huge Capital, and technology.

Key words: petroleum, production oil industry, Iran petroleum contract

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Introduction

Iran was the first oil producing country in the Middle East and this dates from the early 1900s. Thus, Iran is ranked as possessing the second largest oil and gas resources in the world. Petroleum laws evolved as a response to the growth of the industry to meet the changes and challenges inherent in the production. There was not much need for legislation to regulate the industry until the middle of the twentieth century. To compound this situation especially in the Middle East and Africa, the investors and not the countries where it was found became the owners through concessionary requirement.

Until the nationalization of the oil industry in Iran, there was no legislation governing the oil industry. Thereafter, the Act for the Establishment of National Iranian Oil Company, the first NIOCs Articles of Association Act of 1955, the Petroleum Act of 1974, and the Petroleum Act of 1987 came into existence. These legislations, were made to control the entrance, operation and exit of foreign investors in all Iranian sectors including oil.¹ It can be rightly said that there were no laws to regulate petroleum production because there was a paucity of legislation on oil contracts.

This period was taken advantage of by the Western countries and multinational oil investors to reap substantial profits while Iran had a massive loss of national revenues for the country. What led to this was the absence of an adequate legal framework in place. Although contractual frameworks existed and regulated the contractual relationship between the State and international oil companies in the oil producing countries. Iran is among the petroleum producing countries that have operated different types of contractual regimes namely, concessions, Production Sharing Agreements (PSA), Service Contracts, Buy-back and IPC.²

¹ Ahad Gholizadeh Manghutay, Different Approaches and Different Results: A Comparative Analysis of the Nigerian and Iranian Laws and Policies on Controlling the Foreign Corporations [2013] (17) (20) *Journal of Law Policy and Globalization*.

² Nima Nasrollahi Shahri, The Petroleum Legal framework of Iran: History Trends and the Way Forward [2010] (8) (1) *The China and Eurasia Forum Quarterly*112.

The legal framework of the petroleum production in Iran can be classified into: (1) general legislation system (2) Individually negotiated agreements, and (3) Hybrid system³. Iran has undergone all the three phases to meet up with global and regional necessities in the oil industry. This, therefore, necessitates the examination of the legal framework that has thus far regulated the oil industry in Iran. In the process, the possible sources of, and reasons for the profound changes that have taken place will be identified.

The Individually Negotiated Contract Period

The concession agreement was one of the oldest instruments and the legal basis on which the oil was run in Iran.⁴ Thus, oil concession practice has lasted for well over a hundred years. Under the arrangement, Iran gave some guarantees to foreign investors in its oil resources. It is generally acknowledged that the first concession in history was issued to William D' Arcis in Persia in 1901, though others may have existed earlier particularly the former Dutch West Indies.⁵ There were no existing legal frameworks in place during this period. So there was absence of governing law in the first concession contracts. What rather existed was individually negotiated contracts between the two parties.⁶

Also, the absence of any existing legislation made the Shah not to encounter any resistance, and terms of contracts they could agree upon. However, it was revealed from the legal status of the 1920 agreement that it 'was a modification and not an

³ S Saovona, *World Petroleum Arrangements and the Role of State* (unpublished LL.M. Dissertation submitted to the CEPMLP, University of Dundee 1986) Cited in Nima, Nasrallah Shahri, *The Petroleum Legal Framework of Iran: History Trends and the Way Forward* [2010] (8) (1) *China and Eurasia Forum Quarterly*112.

⁴ Homayoun Mafi, 'Iran's Concession Agreements and the Role of the National Iranian Oil Company: Economic Development and Sovereign Immunity' [2008] (48) *Natural Resources Journal*409.

⁵ Yana Zoloeva, 'Will the Concession Agreement Become One of the Possible Legal forms to Exploit the Subsoil in Russia?' [2001] (5) (7) *Russian Energy Law Journal*.

⁶ Ariyankia Reza, *Arbitration Conditions on the Development Way of Law of International Oil Contracts* [2009] *International Legal Journal*200.

interpretation of the D'Arcy concession'. From the perspective of the Iranian Government, the agreement lacked a binding force because the Parliament failed to approve it.⁷ It was also lopsidedly against Iran.

The 1933 Petroleum Concession

The end of the D'Arcy concessions brought into existence the 1933 concession. The terms of the D'Arcy in a way were not quite different from the 1901 concession. The 1933 concession was made for another sixty years (1933-1993). This era was known as classic concession system.⁸ There was no governing law. The Iranian government unilaterally cancelled the agreement and officially published it on 27 November 1932.⁹ The government claimed that the terms of the concession was not in the national interest. Therefore, the government was not bound by it legally and logically since the concessionary terms were granted before the establishment of constitutional government in Iran.

In April 1937, a 60-year term concession with terms and conditions similar to that of 1933 agreement was given to the Americans.¹⁰ This, however, did not last probably because the Americans were not successful in their exploration and, therefore, lost interest in the fields in 1938.¹¹ During the period of this concession, the ownership of all petroleum reserves in the area within the concessionary territory was vested in the

⁷ RB Stobagh, The evolution of Iranian oil policy [1925-1975] *Reprint series / Division of Research, Graduate School of Business, Harvard University* <<https://www.amazon.com/evolution-1925-1975-Division-Research-University/dp/B00072FECA>> 19August2019.

⁸ Ahmad Heidari, The Governing Law of International Oil Contracts in Iran Legislations, *Cumhuriyet University Faculty of Science, Science Journal (CSJ)*, Vol. 36, No: 4 Special Issue (2015), p. 1759. <http://dergi.cumhuriyet.edu.tr/ojs/index.php/fenbilimleri>

⁹ Text in League of Nations, *Official Journal*, 13 Dec. 1932

¹⁰ Mohammad Malek, 'Oil in Iran between the Two World Wars', (Jan.20, 2010). Consortium had its disadvantages. However, it enabled Iran to negotiate new concessions on the fields. She was able to recover from it. http://www.iranchamber.com/history/articles/oil_iran_between_world_wars.php

¹¹ Ibid.

concessionaire. The concessionaire could decide what to do with its petroleum reserves including other mineral resources found in the same area or territory. A common characteristic of these agreements is that they were usually for a long period. There were also no legal restrictions on foreign investments. Total risk involvement was born by the concessionaire and the government was not involved in the mining of the concession, neither did it exercise any control.¹²

The Nationalization of the Oil Industry

Iran was the first country to nationalize its oil reserves. On February 19, 1951, a democratically elected Parliament of Iran led by Prime Minister Mohammad Mossaddegh proposed to the Iranian Parliament that the oil industry be nationalized. Thus, the British owned Anglo-Iranian Oil Company (AIOC) was nationalised in March 1951.¹³ The text of the law nationalizing the Iranian oil industry stated that:

For the Happiness and Prosperity of the Iranian Nation and for purposes of securing world peace, it is hereby resolved that the oil industry throughout all parts of the country, without exception, be nationalised, that is to say, all operations of exploration, extraction, and exploration shall be carried out by the Government.¹⁴

The Iranian nationalisations were justified on the ground that colonialists pillaged the economy of the country. This was

¹² NN Shashri, *The Petroleum Legal Framework of Iran: History, Trends and the Way Forward* China and Eurasia Forum Quarterly, Volume 8, No. 1 (2010) P. 115.

¹³ *The Official Gazette of the Islamic Republic of Iran, 12 Esfand 1330* [May 2, 1951]. (adopting The Law of Nationalization of Oil Industry on March 20, 1951). For the English translation of the Law, see M. W. Whileruan, 8 *Digest of International Law* 1074 (1967).

¹⁴ Passed by the Majlis on March 15, 1957, and by the senate on March 20, 1957. Source of Text: Iranian Embassy in Washington, DC, some Documents on the Nationalization of the Oil industry in Iran (1951) 2 in Alan Ford, *The Anglo – Iranian Oil Dispute of 1951 – 1952: A study of the Role of Law in the Relations of States* (1954) 268.

the general opinion of the colonised people. In the same vein, the General Assembly (GA) of the UN also pursued policies supporting the struggles for economic independence. Thus, the fundamental objectives of Iran's nationalization were establishment of Iran's sovereignty, ownership and control of the country's oil industry and resource. Furthermore, to mobilize oil resources for national development which needed to be financed largely from oil revenue and foreign borrowing.¹⁵ It was also meant to curb British political and economic influence in Iran.

The nationalisation law was validated by both Iranian Parliaments. The entire oil industry became nationalised and all relevant stages 'including exploration development and exploitation were to be carried out and controlled solely by the Iranian government'.¹⁶ For the first time in the Iranian history, Iran was legally considered the owner of her petroleum wealth. As a result of nationalization, Iran became a forum of 'Great Power rivalry'. There were disputes between the Iran Government and the AIOC. This resulted in political disagreement involving both the UK and the US.

The plan for nationalization and Iranian ownership of its oil asset came to an end when America and Britain organised a joint Anglo-American backed military coup and overthrew the democratically elected government¹⁷ in 1953. After Mossadegh's government was overthrown, oil rights were granted in 1954 to a new consortium consisting of seven major American oil companies and British Petroleum including AIOC. Under this arrangement the companies were to provide and market oil in an area of 100,000 squares miles in Southern Iran. The oil agreement of 1954 provided the objectives thus:

¹⁵ The GA Resolution adopted just after one year later declares that: '... the right of peoples to freely use and exploit their natural wealth and resources is inherent in their sovereignty and is in accordance with the Purposes and Principles of the Charter of the United Nations'. Right to exploit freely Natural Wealth and resources, GA Res 626 (vii), UNGAOR, 7th session, UNDOCA/Res/626 (vii) (1952).

¹⁶ Nationalization Act, Iran National Parliament, (1951).

¹⁷ Mostafa Elm, *Oil, Power, and Principle: Iran's Oil Nationalization and its Aftermath* (New York: Syracuse University Press, 1992).

A substantial export market for Iranian Oil as a means of increasing the material benefits to and prosperity of the Iranian people, and to the companies, on the other hand, the degree of security and prospect of reasonable rewards necessary to justify the commitment of their resources and facilities to the reactivation of the Iranian oil industry.¹⁸

The Consortium Agreement ‘gave to the Iranians a shadow of what they sought, while retaining for the British the substance of what they had’.¹⁹ The Consortium Agreement 1954, attempted to nationalize the governing law condition. The agreement was very complicated. Its sheer lop-sidedness. So, it caused more confusion. Iran in fact got what it did not bargain for because she was denied her share in the consortium.²⁰ Article 46 of this agreement required that: ‘Since the parties to this agreement are from different nationalities, the interpretation and implementation of this agreement will follow the legal principles which are generally accepted by the civilized nations’.²¹ It made Iran an owner with no rights.²² The contract was for 25 years, but could be extended by 15 years. The agreement further provided that the consortium was exempted of all custom tariffs and taxation.²³

The act of nationalization became a model for the nationalizations of oil industries in Northern and Sub-Saharan

¹⁸ Nwogugu EI, *The Legal Problems of Foreign Investment in Developing Countries*, (Manchester: Manchester University Press, 1965).

¹⁹ Feriedun Fesharaki, *Development of The Iranian Oil Industry: International And Domestic Aspect* 22 (1976).

²⁰ Harvey O'Connor, "How the international oil cartel carved up the oil resources of Iran after the overthrow of Mossadegh; A full account of a little known story by an expert in the oil industry field: The Iranian Oil Grab" (April 1955)
https://www.marxists.org/history/etol/newspape/amersocialist/amersoc_5504-a.htm. Accessed 27-12-2018.

²¹ Mohmoud Toloui, *Power game, Oil war in the Middle East* (Tehran: Elm Publications 1993).

²² Mohammad Amir Sheikh Noori, "The consortium concession (in Farsi), <http://www.zamaneh:info/articles/875.htm> (Jan. 20, 2010).

²³ Article 28 of the 1953 Oil Consortium

African countries. Some of these countries include Egypt (1956) Algeria (1967) Libya (1978) Nigeria (1978-1979) and Gabon (1974).²⁴ The organization of Petroleum Exporting Countries (OPEC) was founded in 1960. The founding members were Iran, Saudi Arabia, Venezuela, Kuwait, and Iraq. Its existence further gingered the spirit of oil nationalization in the Gulf countries one by one.²⁵ Mossadegh succeeded in nationalising Iranian oil but failed in making nationalisation work for the benefit of his country. Although he succeeded in removing from Iran the last remnant of foreign control. Its impact became obvious as it gave a devastating effect on the Western economies which were major importers and consumers of oil. Thus, its wave posed a big challenge to the legal status of foreign-investments. It was contested and that made it to be unstable and uncertain. Moreso, under traditional public international law, the regulation of nationalization was the exclusive preserve of the state conducting nationalization.²⁶

According to Robert Graham, it was ‘the only way in which Iran could assert its independence and maximize its potential oil resources.’²⁷ The Nationalization Act also authorized the NIOC to be engaged in exploration, exploitation, and selling of Iranian crude. It operated as a government agency. Thus, NIOC has its origins in the nationalization of oil industry law of Iran (1951) and subsequently by the law Regulating Nationalization of the oil industry.²⁸

²⁴ SEMP INC, what is Rentier State? (2005) Sub – Urban Emergency Management Project. <<http://www.scriptiesonline.uba.uva.nl/document/138220>> Accessed: 16, August 2019.

²⁵ Ibid

²⁶ Finnegan, Middle East Oil: An Historical Perspective and Out -look (2003). See also the ICJ ruling in Anglo- Iranian Oil Co case (*UK v Iran*) (1952) ICJ Rep 93, 24.

²⁷ Robert Graham, Iran: The Illusion of Power, (Berg Pub Ltd; First Edition, October 1, 1980).P 36

²⁸ R K Ramazani; Choice-of -Law Problems and International Oil Contracts: A case study, 11 International Law and Comparative Law Quarterly, (1962) 503, 516.

1957 Petroleum Law²⁹

Until the 1951 nationalization of the Iranian Oil industry, oil industry activities were conducted by foreigners. The government played the role of a ‘bystander watching.’³⁰ The situation has been captured by Ramazani in the following:

After the passage of the Nationalisation Law (1951), the Iranian government went to the other extreme by controlling all operations of exploration, extraction and exploitation. The grave economic and political conditions that ensued in subsequent years revealed that realism demanded modernization. Thus, it was decided to encourage the flow of foreign investment in oil, but at the same time provide for Iran’s participation through some kind of partnership with foreign oil concerns.³¹

The 1957 law was the first petroleum law of Iran.³² The establishment of the consortium legislation of the 1957 was a tacit acknowledgement of the failure of the previous system i.e. complete control and ownership provided for by the oil Nationalization Act of 1951. The Act created a legal background to further cooperation with other IOCs for attracting much needed investment and technology. The Act introduced a number of Petroleum sharing contracts and Joint Operating Agreements between Iran and several international oil companies with government participation. Thus, the Act provided a new basis for oil exploration in Iran. The Act ‘was one of the first well-

²⁹ The Law regarding exploration, discovery and extraction of Oil in all regions of the country and Continental Shelf, National Parliament of Iran, 1957.

³⁰ R Ramazani, ‘Oil and Law in Iran’ *Journal of John Bassett Moore Society of International Law* 2 (1961 –1962):s 56, cited in; Niklas Swanström, Institute for Security and Development Policy, *The China and Eurasia Forum Quarterly*, Central Asia-Caucasus Institute & Silk Road Studies Program, Volume 8, No. 1, 2010.

³¹ The Law regarding exploration, discovery and extraction of oil in all regions of the country and Continental Shelf, National Parliament of Iran, 1957.

³² Encyclopedia Iranica (2018) “Oil Agreements in Iran” Article Table of Contents.

thought-out and comprehensive Petroleum laws of any oil-producing country.³³

Under the Joint Venture, Iran's participation was 30%.³⁴ The law³⁵ provided for a duration of 25 years not leaving the IOC with more than 1000 square kilometres³⁶ with compulsory relinquishment requirements starting after 10 years.³⁷ The law made foreign companies liable to all forms of taxes. During the period of its existence, up till 1974, Iran entered into a number of Joint Operating Agreements (JOAs) and Production Sharing Agreements with IOCs.³⁸

In 1966, the NIOC entered into service contracts³⁹ and based on this arrangement as provided by the Act,⁴⁰ foreign companies, worked as contractors for the NIOC but never exercised the right of ownership in the country. It must be noted that the emergence of joint ventures was as a result of the weakening of the international oil majors. Furthermore, the coming into existence of Oil Producing and Exporting Countries. the 1957 Petroleum Act made possible the operations of research, explorations and extraction of Petroleum throughout the country and the continental shelf. It also intended to include operations of refining, transportation and sale of all petroleum. NIOC was

³³ Fereidun Fesharaki, note 1145, (1976).

³⁴ Article 6, The Law regarding exploration, discovery and extraction of oil in all regions of the Country and Continental Shelf, National Parliament of Iran, 1957

³⁵ Ibid, Article 7, Paragraph 4.

³⁶ Ibid, Article 8, Paragraph 6.

³⁷ Ibid, Article 7, Paragraph 3.

³⁸ Bob 'zPalmer and Amir Kordvani, 'Oil Regulation in Iran' <<https://gettingtheearththrough.com/jurisdiction/98/iran/>> accessed: 16 August 2019.

³⁹ In service contracts, "the investor provides the entire risk capital for exploration and development which is reimbursed with interest, in cash or part of the oil produced, if the field proves productive. This is a form of production sharing where the contractor is compensated only upon discovery." Kamel I.F. Khan, Petroleum Taxation and Contracts in the Third World, A Law and Policy Perspective, 22 J. World Trade, Feb. 1988, at 67, 84.

⁴⁰ Article 2 of the Petroleum Act of 1957. Article 2 holds that: In execution of the provisions of this Act, the National Iranian Oil Company may negotiate with any person, whether Iranian or foreign, whose technical or financial competence shall have been established, and may conclude with such person any agreement which it deems appropriate, on the basis of the terms and stipulations of this Act and other conditions not inconsistent with the laws of the country.

permitted to enter into contractual relationships with persons, Iranian or foreign, possessing the requisite technical and financial competence, with the aim of developing hydrocarbon resources of Iran. The Act envisaged three vehicles for such activities:

1. The Mixed Organization which would be a juridical person/entity owned partly by NIOC and partly by the so-called Second party.
2. The Joint Structure which would be an operating entity created by NIOC and the Second Party without a separate juridical personality resulting from such combination.
3. An independent operation: This third vehicle was introduced in order to encompass the Consortium Agreement.

The contract between ENI and Iran signed by an ENI subsidiary AGIP Minraria was the first participation agreement based on the Petroleum Act of 1957. In this contract, oil exploration costs were to be paid by AGIP. However, the costs can be returned only if the operations result in the exploration of oil to a trade amount. This contract was followed in 1958 by two participation contracts which were also signed between Iran and Pan American Petroleum Company (IPAC Agreement). This agreement was negotiated and concluded between NIOC and Pan American Corporation (owned by the Standard Oil Company of Indiana) in conformity with the bidding procedures as envisaged in the Petroleum Act of 1957.⁴¹ The final oil contracts that were written based on the Petroleum Act 1957 were the ones between NIOC and a group of Japanese companies, and those signed between NIOC and some dependent American companies and Mobil company.⁴²

⁴¹ Encyclopedia Iranica (2018) 'Oil Agreements in Iran' <http://www.iranicaonline.org/articles/oil-agreements-in-iran> Accessed: 16 August 2019.

⁴² Ahmad Heidari, The Governing Law of International Oil Contracts in Iran Legislations, Cumhuriyet University Faculty of Science, Science Journal (CSJ), Vol. 36, No: 4 Special Issue (2015), p. 1758, <http://dergi.cumhuriyet.edu.tr/ojs/index.php/fenbilimleri> , Movahed, Muhammad Ali, (2005). Nationalization and Compensation: Oil Arbitrations, Karnameh, Tehran.

In 1965, Philips Petroleum company (the parent company of the claimant, incorporated in the Delaware), AGIP (an Italian company), and the oil and natural gas commission of India (the commission), entered a contract or “joint structure Agreement” (JSA) with the respondent National Iranian Oil company (NIOC) for the exploration and exploitation of petroleum resources in the Persian Gulf. The JSA’s preamble labelled NIOC the “first party” and the Philips, AGIP and the commission collectively, the “second party”. Philips and the commission later assigned their rights and obligations under the JSA subsidiaries, Philips petroleum company Iran (the claimant) and hydrocarbons India Private LTD (HIL) respectively, which then became along with AGIP the second party under the JSA. For the purposes of the JSA the parties established an operating company the Iranian marine International Oil company (IMINOCO).⁴³

1974 Petroleum Act and Risk Service Contracts⁴⁴

To enhance its control and management of the petroleum operation carried out on its behalf by qualified operators, the national NIOC drafted a new and innovative Petroleum Act in 1974.⁴⁵ Consequently, it was enacted by the Parliament. The Act, brought to an end the 1957 Law.⁴⁶ Based on this law, the oil industry was once again declared national much more than before. However, the NIOC was permitted to attract investments only through ‘Risk Service Contracts’. Under this law, foreign companies are merely contractors.⁴⁷ They received remuneration in return for the services rendered and are not entitled to any oil

⁴³ *Philips Petroleum Company Iran v. The Islamic Republic of Iran & the National Iran Oil company* Award of 29 June 1989, 21 Iran-US CTR 79 (1989-1)

⁴⁴ *Ibid*, p. 1759.

⁴⁵ Petroleum Law, National Iranian Parliament, Iran Senate, 1974

⁴⁶ *Ibid*, Article 29, Paragraph 6.

⁴⁷ Section 1 of Article 3 of 1973 Petroleum Act, (the text of the Act was published by Public Relations Affairs, Iranian Oil Industry in 1974).

neither in the reservoir nor well head compared to the previous concessions and Petroleum Sharing Agreements.⁴⁸

Based on the Act, the NIOC was allowed to add provisions so as to meet the interests of the country to individual contracts it entered into, which required parliamentary approval. It also provided that contract terms would be divided between exploration and exploitation. The exploration being extendable for a period of five years.⁴⁹ The contractor had no ownership right neither to the reserves discovered nor to the production from the agreement area. Section 1 of Article 3 in a telling clause stipulated that:

The Petroleum resources and the Petroleum industry of Iran belong to the nation. The exercise of sovereignty right of Iranian nation over the Petroleum resources of Iran with respect to the exploration, development, production, exploitation, and distribution of Petroleum throughout the country and its continental shelf is entrusted exclusively to the National Iranian Oil Company who shall act thereupon directly, or through its agents and contractors.⁵⁰

Article (3) of the Petroleum Law provides that all oil and gas resources, including the industry should be nationalised.

According to these provisions of the Petroleum Act, the engagement of OICs in exploration, development and production has become limited to cases where the foreign companies acted on behalf of NIOC as its contractors. In view of the provisions of this Act, agreements such as concessions, production sharing or joint-venture contracts concluded in which the foreign oil multinationals were not engaged as contractors under NIOC, became prohibited. In place of those prohibition was the risk service contract. It was developed within the directive of the Act

⁴⁸ NN Shashri, *The Petroleum Legal Framework of Iran; History, trends and the way forward*, China and Eurasia Forum Quarterly, Volumes 8, No. 1 (2010), p. 118.

⁴⁹ *Ibid*, p. 118.

⁵⁰ (The text of the Act was published by Public Relations Affairs, Iranian Oil Industry in 1974).

or legislation, and abased on that a number of such contracts were concluded.

Under risk service contracts, the costs of exploration and development, and associated risks, were to be borne by the IOC, acting as NIOC's contractor. In the same vein, if a commercial field was found and subsequently developed, a portion of the oil produced from the field was to be sold to the IOC at prevailing market prices for recovery of costs. Also, the IOC was entitled to purchase a percentage (i.e., 5%) of oil produced from the field at a discount (i.e., 5% less than the market price) as reward for risks taken. In case no commercial field was found, the contract would be terminated and expenses borne solely by the IOC. However, the Consortium remained in force and unaffected by legislation made by Parliament until the 1979 Islamic revolution.⁵¹

1987 Law⁵²

Then began a new era of Petroleum legal framework in Iran. This was ushered in by the 1979 Islamic Revolution. The beginning of this new era brought to an end the consortium agreement and other contracts that were deemed contrary to law. During this period, every contractual regime was confined within the legislative framework in existence within the 1987 law.⁵³ This was the first and last Petroleum Law of Iran after the 1979 revolution and it abolished all previous legislations.⁵⁴ The oil ministry, according to section 3, is entrusted with exertion of rights and powers prescribed in the Act.

The 1987 Petroleum Act repealed all previous petroleum legislations and has remained the principal piece of legislation regulating the industry. Since 1995, Iran has adopted a risk-service buyback contract model, to encourage foreign investment in its upstream petroleum sector. The use of a risk service model

⁵¹ Ibid.

⁵² Petroleum Law, Iranian Islamic Parliament, 1987.

⁵³ Ahmad Heidari, The Governing Law of International Oil Contracts in Iran Legislations, Cumhuriyet University Faculty of Science, Science Journal (CSJ), Vol. 36, No: 4 Special Issue (2015), p. 1759. <http://dergi.cumhuriyet.edu.tr/ojs/index.php/fenbilimleri>

⁵⁴ Article 12 of the Petroleum Law, Iranian Islamic Parliament, 1987.

effectively circumvents the prohibition in the Iranian Constitution on granting mineral concessions to foreign entities.⁵⁵ Iranians were pessimistic about the engagement of foreign investors in economic activities. Hence in the newly enacted Act a total ban was imposed on foreign investment.⁵⁶ A total change in the Act was the replacement of the NIOC.

Under the Act all petroleum activities must be carried out under the control and supervision of the Oil ministry established after the Islamic Revolution. However, the NIOC and other national companies in the petroleum sector have continued, to this day, to deal with all matters related to petroleum under the auspices of the petroleum ministry. Under Article (2) of the said Act, petroleum resources are regarded as part of the public domain. That is to say it belongs to the Iranian people and remains at the disposal and control of the Government. This position was restated in the Act Amending the 1987 Petroleum Act of Iran (2011). It provides that such 'public wealth' is at the disposal of government 'for it to utilise in accordance with the public interest, thus section 2 is in tandem with article 45 of the constitution.

Furthermore, article (6) of the Act, provides that all capital investment needed for oil and gas projects shall be proposed by the Ministry of Petroleum which has to form or be included in the annual budget. However, under Article (5) of the same Act, the Ministry of Petroleum and affiliated companies (e.g., NIOC) are permitted to enter into contracts with local and foreign individuals or companies for the purpose of carrying out oil and gas projects.

Conclusion of EDAs between Ministry of oil and foreign natural persons and legal entities and determination of the major cases shall be subject to and governed by the By-laws to be

⁵⁵ Bob Palmer and Amir Kordvani, 'Oil Regulation in Iran' <<https://gettingthedealthrough.com/area/24/jurisdiction/98/oil-regulation-2017-iran/>> accessed: 16 August 2019.

⁵⁶ Ahmad Heidari, The Governing Law of International Oil Contracts in Iran Legislations, Cumhuriyet University Faculty of Science, Science Journal (CSJ), Vol. 36, No: 4 Special Issue (2015), p. 1759. <http://dergi.cumhuriyet.edu.tr/ojs/index.php/fenbilimleri>

approved by the council of ministers upon the approval of the oil ministry, it must conform with the provision of section 77 of the constitution of Iran, that is, the Islamic Consultative Assembly must ratify it. Section 8, however, provides that in the case of fixed capital investment of the oil industry it shall be subject to and governed by the laws and regulations of relevant agencies, in the absence of which, the general regulations of the Islamic Republic of Iran. It is noted that since the 1979 Revolution, a redundant bureaucratic system has been built around the oil industry.

The Ministry of oil and the National Iran oil company duplicating one another's work while lacking accountability and transparency, and therefore complicating the legality and efficiency of dealings conducted with these structures. Confirming this, FACTS Inc, notes that there is no integrated approach and each group is negotiating on their own. Who wins is the decision of the Minister himself.⁵⁷ In the same vein Dr Mina also observes that the structure of these authorities is not clear, as over a hundred companies affiliated with the Oil Ministry and NIOC have been created since the revolution, making dealings with the authorities cryptic and difficult.⁵⁸

1979 Iranian Constitution and Investment in Oil

The Islamic Constitution of 1979 preceded the Islamic revolution. Before 1979, it was alleged that the natural resources were poorly managed. Thus, in the 1979 Constitution specific reference is made to natural resources and concessions.⁵⁹ The constitution took an idealistically strict position so as to minimise corruption, foreign control and management. Therefore, this study will take into consideration the articles in the Constitution

⁵⁷ Ghorban Nasri, 'Middle East Economic Survey: The need to Reconstruct Iran's Petroleum Industry' <<http://www.mees.com/postedarticles/oped/v48n24-5OD01.htm>> accessed: 16 August 2019.

⁵⁸ Kakhki, Mohammad Mehdi Hedayati, *A critical analysis of Iranian buy-back transactions in the context of international petroleum contractual systems*, Durham theses, Durham University. (2008) P. 360. Also available at Durham E-Theses Online: <http://etheses.dur.ac.uk/2931/>

⁵⁹ Articles 44, 45 and, 81 of the Constitution of the Islamic Republic of Iran, 1979.

having to do with mineral resources particularly petroleum resource. These articles include Articles 44, 45 and, 81.

The Iranian Constitution forbids foreign ownership of natural resources. Thus as provided in Article 44 of the 1979 Constitution natural resources are owned and controlled by the state. Consequently, all major industries are nationalized and Private ownership is disallowed including the petroleum industry cannot be privatized. The said article not only forbids any form of private ownership, it also prohibits private participation i.e. investment, be it foreign or domestic by using the words ‘owned and controlled by the state’. In article 45, natural resources is regarded as *Anfal*’ and it provides thus: Oil and Gas reserves are part of “*Anfal*” commonly owned resources under Iranian law.⁶⁰ This article regards mineral resources as “*Anfal*,” namely, public wealth and property, which is an Islamic concept mentioned in the Holy Koran 33.

As provided in the Holy Koran, *Anfal* belongs to God and the Prophet. All Iranian laws are based on and must be in tandem with Sharia Islamic teachings. This constitutional provision of Article 44 leaves *Anfal* to the Government. It is the responsibility of the Government to administer it in public interest. As expressed by Seyyed Mehdi “The ownership of the reservoir belongs to the people and cannot be transferred”.⁶¹ *Anfal* is not transferable or sold to anybody. This creates a barrier when negotiating PSC agreement which is among the most attractive contracts in the oil and gas industry. It constitutes a barrier to private party be it foreign or domestic. Article 81 is on foreign Concessions. It forbids the concessionary system completely. Thus the article provides: The granting of concessions to foreigners or the formation of companies or institutions dealing with commerce, industry, agriculture, service, or mineral extraction is absolutely forbidden.

⁶⁰ Article 45 of the Constitution of the Islamic Republic of Iran. (*wipo.int*, 2019) <<https://www.wipo.int/edocs/lexdocs/laws/en/ir/ir001en.pdf>> accessed 9 may 2019.

⁶¹ *Ibid*.

The phrase ‘absolutely forbidden’ as stated in Article 81 of the 1979 Iranian Constitution means it cannot be legitimized even if the Parliament approves of it. Consequently, the government cannot grant foreigners rights to form companies or institutions dealing with mineral extraction. The provision of Article 81 has been relied on as the basis for no legal Joint Operating Agreements or joint ventures. Furthermore, only the government is the authority which can legitimately deal with natural resources. Employment of foreign experts was restricted⁶² and also control by foreign persons over natural resources was prohibited.⁶³

Thus, it can be inferred from the constitutional provisions of articles 44, 45 or 81, that participation and control, ownership or establishment of foreign companies respectively is not allowed. To compound issues the steps to alter the constitution is complex as expressly provided in Article 177 of the Constitution. This include permission by the Supreme Leader, heads of the government branches, various judiciary, religious and academic officials, as well as the approval of a country wide referendum. The fact remains that a country can have a perfectly designed contractual framework and still fail to experience growth in its oil production when foreign investors are not protected by law. Laws governing EDAs and investors work in concert with contractual structure laws to bring about a strong EDA.⁶⁴ Investors need assurance that their investment are secure and must have legal recourse in the event a deal goes wrong. Chile is one of those countries.⁶⁵ The country’s legal system affords strong legal protection to foreign investors. The principles of Chile’s foreign investment regulation are provided in the country’s political constitution.⁶⁶ The situation is different in Iran. Chile’s regulatory

⁶² Article 82 of the Constitution.

⁶³ Article 153 of the Constitution

⁶⁴ Andrew Hill, *Foreign Infrastructure Investment in Chile: The Success of Public-Private Partnerships through Concessions Contracts*, *Northwestern Journal of International Law and Business*, 32:165 (2011), p. 190.

⁶⁵ *Ibid*, p. 180.

⁶⁶ *Foreign Inv. Comm., Ministry Of Pub. Works, Chile, Opportunities in Infrastructure 2009–2010* 6 (2009). Cited in: Andrew Hill, *Northwestern Journal of International Law & Business*, *Foreign Infrastructure Investment in Chile: The Success of Public–Private Partnerships through Concessions Contracts*, Vol. 32, Issue 1, p. 166.

framework has remained stable and predictable and the contract specify that any unilateral change must be compensated for.⁶⁷

Furthermore, a significant proportion of these enabling authorities are conservative in nature, it is therefore very unlikely that the oil regime would be liberalized.⁶⁸ This situation sometimes put foreign investors into confusion because of the severe restrictions on oil transactions imposed by the constitution through the buy-back. The Iranian authorities insist on these restrictions despite the possible economic advantages of utilizing a different contractual arrangement such as the PSA. However, a careful analysis of the historical context of the Iranian national wealth, its irrational acts may not be condemnatory especially as it is founded upon historical precedent of similar abuses.

Concessions, PSA and Joint Operating Agreements or any other contractual arrangements of similar nature are prohibited as provided in the Constitution. This therefore suggests that Iran's oil industry is not liberalised. It is rather restrictive and static and nationalistic. Also, there are too many laws and institutions which may hinder a smooth contractual relationship between Iran and oil companies. Considerable restrictions were imposed by the Constitution on participation on economic activities conducted by private sectors and particularly by foreign investors. Many economic sectors became nationalised.⁶⁹ Foreigners were denied the right of establishing companies in Iran.⁷⁰ They were not also granted concession.⁷¹

The Iranian Legal System has created one of the biggest obstacles to foreign investors in EDAs. For example, presently in Iran, international law that contrasts with domestic law is not enforceable.⁷² In the same vein, there are no basis for enforcing any verdict or decision of an international court. International law

⁶⁷ Ibid, 180.

⁶⁸ Khaki, Mohammad Mehdi Hedayati, note 60, (2008)

⁶⁹ Article 44 of the constitution of the Islamic Republic of Iran

⁷⁰ Article 81 of the constitution of the Islamic Republic of Iran

⁷¹ Ibid

⁷² Reza Yeganehshakib, PhD., Iran's New Generation of Oil and Gas Contracts: Historical Mistrust and the Need for Foreign Investment, The Journal of Political Risk, vol. 4, no. 2, February 2016, p. 12/26.

can only become relevant after the implementation of both domestic laws and regulations especially if there is a gap in the domestic law and regulation.⁷³

Furthermore, if parties have contending issues that cannot be resolved resulting from lacuna in the domestic laws or regulations, resort can be made to international laws to resolve it.⁷⁴ The changes in the applicable laws to EDAs are usually attributed to political and legal developments. This is more frequent in Middle East. The consequence of these changes in the governing law has resulted to a serious development toward applying the domestic law of the host state to EDAs. Nevertheless, such law must not be inconsistency with *lex Petrolea*, in a way that this problem was explicitly mentioned in the oil regulations.⁷⁵

Buy-Back Contractual Arrangements in the Oil Explorations and Exploitations in Iran

For more than a decade now, Iran has used the buyback contract⁷⁶ as the main mechanism for the development of oil and gas field. As a result, a number of buyback agreements have been entered into between the National Iranian Oil Company and

⁷³ Ibid.

⁷⁴ Ahmed al-Qushari and Tariq Riadh, trans and discussion by Moshen Mohebi, "The Laws that Rule the New Generations of the Oil Contracts: A Shift in the Judicial Process," *The Legal Magazine*, a publication of the Islamic Republic of Iran's Office of International Legal Services, No. 29, pp. 29-109; November 23, 2003, 29, 36, 42 and 109, cited in; Reza Yeganehshakib, PhD., *Iran's New Generation of Oil and Gas Contracts: Historical Mistrust and the Need for Foreign Investment*, *The Journal of Political Risk*, vol. 4, no. 2, February 2016, p. 10/26.

⁷⁵ Ahmad Heidari, *The Governing Law of International Oil Contracts in Iran Legislations*, Cumhuriyet University Faculty of Science, *Science Journal (CSJ)*, Vol. 36, No: 4 Special Issue (2015), p. 1759. <http://dergi.cumhuriyet.edu.tr/cumuscij/article/view/5000131617/0> Accessed: 16 August 2019

⁷⁶ Buy-back contracts in Iran's oil and gas industry is defined as oil counter purchase as a long or some kind of medium term contracts that whereby a foreign investor through supplying the machineries, equipment, services and intellectual property rights, including patents and trademarks, technology makes a commitment to finance all or part of a project in identifying, oil exploration and exploitation of mining areas or specific areas of oil and gas resources or the development, restoration and modification of existing oil and gas resources.

International oil companies. Its introduction in Iran can be traced back to the Petroleum Law enacted in 1974. After the revolution in 1979, certain restrictions were imposed on economic activities by the private sector generally and, particularly by foreign investors by the constitution. In fact, many economic sectors became nationalized.

In 1987, a new Act was introduced, which imposed a total ban on any form of foreign investment. With this law, buyback was introduced in Iran. The arrangement required the IOCs to provide the funding for and carry out oil projects as NIOC's contractors.⁷⁷ Under this scheme, the risk of any shortfall in the production was taken by the NIOC. The Iranian Central Bank guaranteed repayment of costs. The risks were taken by the IOCs quite unlike a typical buyback which was subsequently introduced by NIOC where the risks of any shortfall in production are placed on the IOC. But it was the Budget Act of 1994 that introduced Buy Back mechanisms as the legitimate source of attracting investment. The Budget Act of 1994 authorized the NIOC to enter into buyback agreements. In this agreement, no guarantee should be provided by any Iranian banks or state enterprises for the recovery of costs and profits in case there is any shortfall in production or any decrease in oil and gas prices.⁷⁸

Under these pieces of legislation,⁷⁹ IOCs have been permitted to invest in certain oil and gas projects through the buyback schemes. A further authorization to enter into and conclude Buy Back was restated in the Second, Third and Fourth Five – year economic, social and cultural development plans of 1995 -1999, 2000 – 2004 and 2005 – 2006 respectively.⁸⁰ There was a major development in buyback in 2003. Hence the Budget

⁷⁷ Oil Regulation, <https://gettingthedealthrough.com/area/24/jurisdiction/98/oil-regulation-2017-iran/> accessed: 16 August 2019. See also, Abdolhossein Shiravi and Nasrollah Ebrahimi.; Exploration and development of Iran's Oil fields through buyback, Natural Resources Forum 30 (2006) P. 200.

⁷⁸ Iranian Official Gazette, 1994.

⁷⁹ Budget Acts of 1993 and 2003

⁸⁰ Abdolhossein Shiravi and Seyed Nasrollah Ebrahimi, Exploration and Development of Iran's Oil fields through buyback, Natural Resources Forum 30 (2006) 199-206 at 201

Act of 2003 which authorised NIOC to include both exploration and development in Buyback contracts particularly section 21 (f). With this provision, NIOC was to carry out exploration activities at the risk of contractors everywhere in Iran. The Budget Act 2003 sets out the following requirements for this kind of buy-back:

- i. 'Exploration activities shall be carried out by the contractor at the contractor's own cost;
- ii. If no commercial field is discovered, the contract will be automatically terminated, and any costs incurred by the contractor relating to the exploration activities shall be borne solely by the contractor;
- iii. If a commercial field is discovered development of the field will be awarded to the contractor based on a buyback mechanism;
- iv. Direct and indirect costs and expenses relating to exploration will be included in the development contract, and will be reimbursed through the allocation of a portion of the resultant output of the project; and
- v. Other statutory requirements mentioned for buyback contracts shall also be respected'.⁸¹

Further statutory authorization was extended in the budget Acts of 2004, 2005 and 2006.⁸² Buyback contracts main objective is to secure state sovereignty over oil and gas resources. Also, to control oil and gas operations as provided in the Constitution, the Petroleum Law of 1974 and the Petroleum Act of 1987.⁸³ Certain provisions specifically drafted to achieve those purposes include among, other, that NIOC authorizes the IOC to

⁸¹ Iranian Official Gazette.

⁸² By Virtue of Notes 21 (Y), (2J) and 2(4), respectively (Iranian Official Gazette, 2004, 2005 and 2006).

⁸³ Adbolhossein Shiravi and Seyed Nasrollah Ebrahimi, Exploration and Development of Iran's Oil fields through buyback, Natural Resources Forum 30 (2006) 199-206 at 201

carry out development operations on behalf of, and in the name of NIOC. The IOC acts as NIOC's contractor, and in addition, all lands acquired and assets purchased shall be the sole property of NIOC. Thus, all materials, articles, equipment and machinery that need to be imported for the project shall be procured by the IOC in the name of NIOC.

Another objective of buyback is to get access to the foreign currency and expertise required for developing oil and gas projects in view of the fact that it is risky, costly and sophisticated. Realising that in a buyback contract, the responsibility of financing and carrying out development operations rest squarely on the IOC.⁸⁴ The Iranian method of concluding contracts in buy-back format letting the foreigners administer the projects alone results in the convenient flow of foreign technology and know-how to the project, but never leads to their indigenization.⁸⁵ However, the buyback contract has been awarded under a joint venture comprised of IOCs and local companies. In this circumstance, each partner is jointly and severally responsible to the NIOC for the financing of the project as well as implementing the project.⁸⁶

Under the current buyback model, IOCs do not assume ownership of production either at the well-head or at an export point. This is contrary to the expectation of the IOCs. Hence it was argued by IOCs that they should be able to own oil and gas allocated to them at the export point and be able to reserve booking in accordance with international stock exchange rules. When the buybacks were announced in 1991, they were unattractive.⁸⁷ It was not investor friendly enough. It did not also provide investors with the certainty and predictability they

⁸⁴ Ibid.

⁸⁵ Ghandi, A., & Lin, C. Y. (2012). Do Iran's buy-back service contracts lead to optimal production? The case of Soroosh and Nowrooz. *Energy Policy*, 42, Pg. 189.

⁸⁶ In the Azadegan project, for example, the buy-back contract was awarded to a joint venture comprised of INPEX of Japan with a Share of 75%, and Naftiran Intertrade Company (NICO), a NIOC affiliate, with a share of 25%.

⁸⁷ Paul Stevens, Middle East and North Africa Programme and Environment, Energy and Resources Department/ March 2015, *Prospects for Iran's Oil and Gas Sector*, Chatham House, The Royal Institute of International Affairs P. 3.

expected unlike the PSA and license agreements.⁸⁸ The IOC 'interest was limited and extremely cautious.' The period of the contract was too short, 'no upside benefit for the IOCs'. The IOCs could not hook the reserves covered by the buy-back on their accounts. They became also too dependent on NIOC's operational control. There was need for change since the buyback was not attracting foreign investors.

The Enactment of Protection and Encouragement Act in 2003⁸⁹ suggests that the Iranian Regime is changing its previously hard stand and xenophobic attitude towards foreign investment. Thus the Act grants assurance to foreign investors, facilitates the approval procedure and introduces contractual mechanisms for foreign investments. It was during this period that the government demonstrated willingness to engage itself in bilateral investment treaties and double taxation treaties with developed countries.

Iran Petroleum Contract (IPC)

There has been a recently designed Petroleum Contract in the upstream oil and gas contracts referred to as IPC, that is, Iranian Petroleum Contract. The contract is an amalgam of Buy back (former upstream contract of Iran) and PSC. In contrast with Buy-Back contracts in which the contractor will be absent in production period, in IPC the contractor is present in the exploration, exploitation stages.⁹⁰ It is similar to Iraq's contract known as technical service contracts. The major feature of IPC in terms of fiscal system is the fee per barrel as a remuneration. This appears to be attractive to industry as it is in Iraq.⁹¹ The general

⁸⁸ Abdolhossein Shiravi and Nasrollah Ebrahimi.; Exploration and development of Iran's Oil fields through buyback, *Natural Resources Forum* 30 (2006) P. 13.

⁸⁹ Protection and Encouragement of Foreign Investment Act, Islamic Parliament of Iran, March 23, 2003.

⁹⁰ Hamed Sahebonar (University of Ferdowsi, Department of Economics), Ali Taheri (University Of Imam Sadiq, Department of Economics), Fazel M. Farimani, (University of Dundee, Department of Economics) *Economic Analysis of New Iranian Petroleum Contract (IPC): The Case Study of Caspian Sea Fields* <<https://www.iaee.org/en/publications/proceedingsabstractpdf.aspx?>> accessed: 16 August 2019.

⁹¹ Ibid

terms received approval from a government economic advisory body on 12 July, 2016, followed by cabinet approval (by council of Ministers resolution) on August 3, 2016. However, the buy-back and IPC are both ‘risk service contracts.

One of the shortcomings of the Buyback contracts tend to be its short-term nature. The duration is in the region of five years as opposed to PSAs which tend to be of much longer term of agreements. Contractual duration is of primary importance especially when it comes to any extensive and capital intensive project such as oil exploration and development.⁹² Petroleum contract is capital intensive beginning with significant initial cost output which is required prior to the period during which sufficient oil is found and produced to enable investors reap the financial rewards.⁹³ Therefore, a very short period production time may result in lack of interest from foreign investors due to the limited scope for profit.⁹⁴ However, an overly long duration may lead to allegations of traditional concessions and 19th century exploitation.⁹⁵

Iran has operated buyback contracts for about 25 years. However, this model is regarded by many as being uncommercial and not profitable to foreign investors. Participating IOCs did not usually commit significant resources to the sector or undertake riskier developments. There was much considerations in the Buy-back arrangements. As a result, the buyback contract could not be relied on to attract the level of capital inflows and technology transfer needed to expand the sector. The need for these concerns to be addressed has been recognized and a new model has been developed. This is the Iranian Petroleum Contract (IPC). The Iranian Government, the National Iranian Oil Company (NIOC) and key stakeholders (including downstream and related industries) all welcomed this development.

⁹² Kakhki, Mohammad Mehdi Hedayati, *note 60*, P. 267.

⁹³ Ibid

⁹⁴ Ibid

⁹⁵ Ibid

This new structural agreement was made public at the ‘Oil Show’ in Tehran at the end of November 2015.⁹⁶ It was a welcomed development by the government economic advisory body on 12 July 2016, thereafter cabinet approval on 3 August 2016.⁹⁷ However, buyback contract and the IPC are both ‘risk service contracts’.⁹⁸ A risk service contract in the petroleum production principally involves a contractor that funds the exploration and development capex. Thus, in return for the right (if it is successful) to recover its costs and to earn a fee, either in cash from production revenues or in-kind. The terms of buyback contracts however remain confidential. The details are not disclosed even to the Iranian Parliament.⁹⁹

The IPC is best described as a modified service contract because it bears a number of fundamental changes to address the shortcomings of the buyback model. Another significant step was taken in August, 2016. It was the approval of a legal framework for the IPC. The government called these contracts Iran Petroleum Contracts rather than buyback or service contracts to distinguish it from the service contract predecessors, particularly in terms of rewards and clarity. Under the IPC, the NIOC will be a signatory to the agreement acting on behalf of the Islamic Republic of Iran. The counterparty will be the contractor which must be in a joint venture with an Iranian partner, utilizing an incorporated joint venture. The Iranian partner in the joint venture must hold at least a 51% interest.

In the new IPC, certain features abound. It accommodates internationally recognised oil and gas concepts wherever possible and provides investors with a more fairly balanced risk-reward allocation. It also provides enhanced fiscal incentives for challenging operations. Investors have a greater voice throughout the production phase. Under IPC, a more complete transfer of leading technology is encouraged. These will

⁹⁶ King and Wood Mallesons, *The Iranian Petroleum Contract: Foreign Investment reform in Iran’s Oil and Gas sector*. www.lexology.com/library/detail.aspx?g Accessed August 23, 2016.

⁹⁷ Ibid

⁹⁸ Ibid

⁹⁹ The Petroleum Finance company, *Upstream Brief* (21 January, 2000).

promote an accelerated development of the Iranian oil and gas industry through partnership, training and local content obligations.

Under this new arrangement, the first party or employer is Iran's ministry of oil and the second party is the contractor (IOC).¹⁰⁰ Contractors under this contract arrangement are paid based on each barrel of oil produced. Besides this, there is also rewards for each excess barrels of oil.¹⁰¹ In the IPC, if a contractor is successful in finding a commercial scale reservoir, it will receive the consecutive phases of the operations contracts including development and production. Minimum exploration requirements and time line of the requirement should be clear in all the contracts as well.¹⁰² There is less ambiguity in these contracts especially as it concerns production phase, since the costs are not fixed and the Cap in each case will be determined periodically.¹⁰³

It is also provided in the IPC law that the contractor has no ownership of the oil and gas inside of the reservoir.¹⁰⁴ However, foreign investors can sign production contracts with a duration of up to 25 years.¹⁰⁵ In the contract structure (IPCs), if an investor does not find a commercial-scale reservoir, it is given another opportunity to perform further exploration work until it succeeds. Thus, it is stated in the IPC law¹⁰⁶ that although the contractor who is the second party in contract accepts all the risks of exploration, if the exploration contractor is not successful in finding a commercial-scale field or reservoir, another exploration block will be assigned to it with the same conditions stated in the original contract. The purpose of this is to reduce the high level

¹⁰⁰ Protection and Encouragement of Foreign Investment Act, Islamic Parliament of Iran, March 23, 2003.

¹⁰¹ Article 1, Section 20

¹⁰² Ayar Online, February 2, 2014, <http://ayaronline.ir/1392/11/46873.html> accessed August 1, 2014.

¹⁰³ See Art. 1, Sec. 27 & Art. 8, Sec. 5.

¹⁰⁴ Article 3, Section 1.

¹⁰⁵ Parisa Hafezi and Jonathan Saul, "Exclusive: Iran sweetens oil contracts to counter sanctions and price plunge," Reuters, February 3, 2015, accessed: February 3, 2015, <http://www.reuters.com/article/2015/02/03/us-iran-oil-sanctions->

¹⁰⁶ Article. 6, Section. 2, subsection 2.

of risk for foreign partners involved in the upstream energy investments.¹⁰⁷

In Iran EDAs, much importance is attached to ‘National interests’. Hence the Iranian Oil Ministry’s priority in the IPC is to protect the ‘national interests’ of the country.¹⁰⁸ This attribute has been emphasized in different parts of the IPC law including Article 1, section 6. Therefore, it is the purpose of the IPCs according to the Iranian oil Minister to not only attract foreign investments, but in addition to receive the latest technologies in oil and gas upstream sector.¹⁰⁹ Iran is highly interested in attracting investors to enable the country renovate the oil and gas industries as well as to increase the production of oil and gas exports.

Legal Barriers and Challenges

The IPC law is confronted with some issues which are provided in the Articles of the Law. Take for instance, Article 3, Section 1, the government of the Islamic Republic of Iran has the absolute and exclusive right of ownership of the oil and natural gas resources and reservoirs. It is further provided that the Ministry of Oil shall enforce and practice this right in all contracts. Furthermore, it specified that the oil, gas, gas condensates or any material manufactured as a result of the production operations belongs to the Ministry of Oil which is the first party and employer. The foreign investment has no ownership right over the equipment of the produced oil and gas. Furthermore, all the operations the contractor performs are under the supervision, ownership and on behalf of the First party.¹¹⁰ All the assets, such as buildings, goods, equipment, wells and installations, including the surface ones and those beneath the

¹⁰⁷ Islamic Parliament Research Center, September 30, 2015, accessed: December 1, 2015, <http://rc.majlis.ir/fa/law/show/944062>.

¹⁰⁸ Mehr, News Agency, June 7, 2014, <http://www.mehrnews.com/TextVersionDetail?2305867>. Accessed 30th of August 2014.

¹⁰⁹ Shana: Iranian Oil Ministry Petro Energy Information Network, March 6, 2014, accessed: 8/30/14. <http://www.shana.ir/fa/newsagency/213440>.

¹¹⁰ Article 3, section 7.

ground belong to the Iranian Ministry of Oil from the starting date of the contract.

Another barrier is in the way the Joint Operating Company or joint operating agreement has been structured. The contractor (second party) has to have an Iranian subcontractor /partner with which he/she will work with during the development and production stage.¹¹¹ Under this arrangement, particularly at early stages of the cooperation, the management is to be rotated between the Iranian subcontractors. It is pertinent to state that this joint agreement will not reduce or eliminate any of the foreign contractor's responsibilities and its obligation will remain same.

The article argues that the law should bestow decision making power to the second party. If that is not done it may lead to failure in production operations and that will impact negatively on the second party's fulfillment of its responsibilities. Under IPC Bye-Law, Article 6(D), the IOC (the contractor) cannot transfer all or part of its rights and obligation under the final IPC without the approval of NIOC. According to IPC Bye-law, Article 3 (G), all titles to the facilities and equipment used by IOC (the contractor) for oil exploitation, development and land transportation activities is held by NIOC from the start of the contract.

Another area of concern is dispute settlement. The IPC law fails to provide details on dispute settlement which suggests the possibility that parties can negotiate on their own.¹¹² It has been suggested that the IPC will be governed by the laws of Iran and disputes must be resolved before Iranian courts .However, there is no clear indication that international arbitration is being considered. Other pertinent issues that have not been addressed in the IPC include the waiver of sovereign immunity and stabilization provisions.¹¹³

¹¹¹ Article 1, Section 21.

¹¹² http://www.cms-lawnow.com/ealerts/2017/02/irans-new-petroleum-contract?cc_lang=en

¹¹³ www.nortonrosefulbright.com/.../iran-new-petroleum-sector-opportunities-137752.pdf.

Historical suspicion of ‘the West’ and ‘imperial powers’,¹¹⁴ for years, have become an impediment to amendment of any law in Iran. Iran was perceived as a pawn in the political struggle of the world powers. The concessions made to foreign powers during this period were often acquired through the application of direct political pressure from one of world’s power with whom Iran was not a match. That is, economically and politically. Thus, forcing Iran to accept unfair terms that included tax breaks, unbalanced arbitration, uneven profit sharing and others. The concessions then were heavily biased in favor of the foreign party. This because it failed to guarantee sufficient technological exchange and profit for Iran. In that case leading to instability in the industry and the premature cancellation of these oil contracts. Of significance are the memories of the 1953 coup and the nationalization of the oil industry. These have remained vivid and constitute barriers to giving international companies any ownership of Iran’s resources.¹¹⁵ And perhaps constituted a major factor to the harsh Iranian attitude on foreign investors and intervention today.

There is the cumbersome and complex nature of decision taking on the oil projects. For instance, NIOC prepares technical report which is made public. This followed by a setup tender opening session. Thereafter, the NIOC prioritizes the prepositions and forwards same to the commission for Special Service Contracts Plans at the Oil Ministry. The contract is then submitted for approval by the Deputy Minister of Economics and the Treasury, the Deputy Minister of Foreign Affairs, the Deputy Minister of Industry and Mines, the Deputy Oil Minister and the President’s representative. Then the contracts are now ready to be signed following the approval of the Central Banks Economic Council and Central Banks Financial Contracts Division.¹¹⁶

¹¹⁴ S K Farsoun and Mehrdad Mashayekhi, *Iran: The Political Culture in the Islamic Republic*, (London: Routledge, 2005), 125.

¹¹⁵ Ervan Abrahamian, *The Coup: 1953, the CIA, and the Roots of Modern U.S. Iranian Relations*, (New York: The New Press, 2013), 220;

¹¹⁶ “Various Oil contracts: Buyback Plans and Finance,” Research Centre of the Islamic Republic of Iran’s Parliament, no. 7049 (2004), pp. 3-4, cited in; Reza Yeganehshakib, PhD., *Iran’s New Generation of Oil and Gas Contracts: Historical Mistrust and the Need for Foreign Investment*, *The Journal of Political Risk*, vol. 4, no. 2, February 2016, p. 10/26.

Conclusion

Iran started with much debated oil nationalisation of 1951, next to this was the drafting of its first Petroleum law in 1957 which provided the legal framework for a number of PSCs and joint operation agreements between Iran and IOCs. Finally, in 1987, the first Petroleum law of the Islamic Republic was validated in the Islamic Parliament of Iran. However, other legislative enactments have been added to the main one, to modify the main Act but not to form an independent Petroleum law. Added to these is the 1979 constitution of Iran. After oil nationalisation of 1951 in Iran and the enactment of the first Petroleum Act in 1957, Iran further considered it necessary to determine the governing law of petroleum EDAs. Coupled with the political and legal developments in Iran and other Middle East countries, emphasis began to shift to the law of the host country as the governing law of EDAs inconsistent with *lex petrolea*.¹¹⁷ This further led Iran to enact other laws and evolve new contractual modes.

¹¹⁷ Kurt Butler, "The meaning of *Lex Petrolea* & Difference between *Lex Petrolea* and *Lex Mercatoria*" <https://prezi.com/f0knf6d8gtsb/the-meaning-of-lex-petrolea/> 2nd of October, 2016. *Lex Petrolea*: "It is loosely defined as the body of rules created by the trade community to serve the needs of international trade; it is simply the 'common law' of the industry, instructing and regulating the international petroleum industry. It is developed through national and international energy sector dispute settlements, petroleum legislation, host government contracts, and the industry's business practice i.e. model contracts."