ATIEH ASSOCIATES

Legal Newsletter

November 2001 Vol. 1 No. 1

Parliament Ratifies New Investment Law

Introduction

In June 2001, the Iranian Parliament ratified the new Law on Attraction and Protection of Foreign Investment ("June Version"). However, shortly after its ratification, the Guardian Council rejected various provisions of the June Version as being unlawful under the Iranian Constitution and Islamic principals. As a result, joint meetings were held with representatives of the Parliament and the Guardian Council to address some of the problems as seen by the Council. In late October 2001, the Joint Committee announced that it had ironed out most the differences between the Majles and the Guardian Council and that the new law (now entitled Law on the Encouragement and Protection of Foreign Investment - LEPFI) would be passed soon. In fact, LEPFI was passed by the Majles on November 4th, 2001 (now awaiting the final approval by the Guardian Council after which it would become the new framework for foreign investment in Iran). The objective of this analysis is to identify the main changes that have occurred in the process of moving from the Old LAPFI, to June Version and from there to the November Version.

Please note the following regarding references to the various versions of the foreign investment law:

<u>Old LAPFI</u> – Refers to the Law on Attraction and Protection of Foreign Investment of 1955 which is the current law.

<u>June Version</u> – Refers to the first draft of the new foreign investment law that was ratified by the Iranian Parliament in June of 2001 and vetoed by the Guardian Council.

<u>November Version</u> – Refers to the latest draft that was ratified by the Parliament on November 4, 2001 and is awaiting approval from the Guardian Council.

Background on Old LAPFI

The Law on Attraction and Protection of Foreign Investment ("Old LAPFI") had been passed in 1955 and is the main legislation to date protecting foreign investment. The following are some of the key characteristics of that law which still is Iran's legislation until the November Version is ratified by the Guardian Council (expected around the end of November):

Coverage of Old LAPFI

Under Old LAPFI any foreign natural or legal person importing capital in Iran in the <u>fields of development, production, industries, mining, transportation, agricultural, granting credit and financial assistance to Iranian firms</u> will enjoy the benefits and privileges of this law as long as:

- The investment is in a field open to Iranian private firms;

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- The investment does not involve the granting of any monopoly or other special rights; and,
- The source of the investment is privately owned and no foreign government has a stake.

Definition of Foreign Capital under Old LAPFI

For the purposes of Old LAPFI, foreign capital is defined as:

- Foreign exchange imported into Iran through authorized banks;
- Machinery, machine tools, spare parts, and raw materials as well as other approved equipment;
- Means of transportation (air, land, sea) necessary for the carrying out of projects;
- Patent rights;
- Salaries paid to technical staff in foreign currency before the commencement of a project for the purposes of setting up productive enterprises; and
- All or part of the net profit accrued in Iran and added to the original capital, or invested in some other enterprise covered by the LAPFI.

Once an investment is authorized and registered under LAPFI, it will enjoy full protection of the law including a sovereign guarantee in case of nationalization or taking. Article III of this law provides that:

Repatriation of Profits and Capital under Old LAPFI

One of the main advantages of importing capital in to Iran under old LAPFI was the provision of allowing repatriation of profits in the same currency of the imported capital.

However, a minister decree ratified a few years ago permitted repatriation profits only from proceed of exports of that project. In other words, if a joint venture in Iran wanted to repatriate dividends in hard currency, it could only do so if it had exports and as such foreign currency earnings. The only exception to this was when the government did not permit exports of the products and would then have to provide the foreign currency sources for repatriation of dividends. Such requirements were one of the major setbacks of the Old LAPFI.

Provisions of the June Ve rsion

Following many years of discussion the new Iranian parliament put the proposed draft of a new foreign investment law on top of its agenda. The final version of this bill was ratified in June 2001 and shortly thereafter vetoed by the Council of Guardians.

The June Version retained most of the provisions of Old LAPFI. However, being cognizant of the need for more modern terms, it went further in providing for coverage of "investment" by including certain investment schemes (i.e. Buy Back Agreements) that were not covered under the Old LAPFI. Moreover, the June Version provides for much more areas that foreign investors can enjoy the protection of this law. There is also an attempt to minimize the number of government agencies involved in granting the permission for the investment.

Coverage of June Version

According to Old LAPFI, only foreign investment in the fields of "development, productive, industrial, mining, transport or agriculture" or for granting credit and financial assistance to Iranian firms engaged in the [aforementioned] activities can enjoy the privileges of this [law]. This definition excluded many investments that would not fall under the defined category. Examples would be buy back agreements, BOTs, investments in the service industry, and financing of foreign investments.

Under the June Version "foreign investors who participate in investment schemes that are also open to the Iranian private sector, can enjoy the protection and privileges of this law." Moreover, investments in the areas of providing finance, such as project finance, Build Operate Transfer (BOTs), buy backs, etc. will also enjoy the full protection of this law. As such, the June Version provided for a very broad and comprehensive definition of sectors that could be covered for protection.

The foregoing provides two of the most important differences between the June Version and the Old LAPFI. Namely, the June Version permits protection of foreign investment in all areas open to private investment (as opposed to specific sectors) and it specifically provides coverage for service contracts such as buy back agreements. Since service contracts did not fall within the definition of "investment" due to restrictions in the Iranian Constitution and other laws they could not be protected under Old LAPFI. It should also be noted that the June Version also extended coverage to capital belonging to Iranian expatriates who utilized and imported such capital into Iran.

Types of foreign Capital Accepted under June Version

The following were considered foreign capital subject to protection under the June Version:

- Hard Currency
- Machinery and Equipment
- Spare parts and tools, CKD's, SKD's, raw materials, etc.
- Intellectual Property in the form of patents, technical know-how, trade marks and trade names, and technical services
- Profits that are added to the capital of the investment
- Other items that have been approved by the relevant authorities

The foregoing is very similar to the provisions in the Old LAPFI as far as definition of foreign capital. However, the protection of financing schemes such as buy backs, BOT projects as well as project financing were also extended protection by the government.

Privileges of Foreign Investors under June Version

Those investors registering under the June Version would have benefited from the following privileges:

- Nationalization can occur only in case of national interest, pursuant to legal regulations, in a non-discriminatory manner, and only by providing for fair compensation according to the real value and before the nationalization occurs.
- Foreign investors will enjoy the same privileges, exemptions, and mechanisms available to local private investors and capital.
- Foreign investors can invest in all fields open to Iranian private investors.
- Residency, work permits, and travel of foreign special-

ists and managers will not be subject to the general laws of Iran. A separate regulation will determine the above.

- Investments registered under this law will benefit from the privileges of this law for a period of 10 years unless a more favorable law is enacted.
- Iranian expatriates were also included under this law.
- Foreign investors could repatriate profits thorough other channels beside export proceeds such as purchase of foreign currency from the banking system. Therefore, those investments targeting only the domestic market – with no targets for exports – are capable to repatriate profits in hard currency by purchasing foreign currency through the banking system.
- Foreign state owned entities and international organizations may have also benefited under this law.
- The highest prevailing rate of foreign currency (market rate) can be used as opposed to the "official rate".
- Any dispute between the government and the investor can be resolved through an agreed upon method or a bilateral investment treaty. This could possibly mean that the investors can provide for a foreign arbitration and choice of law clause.
- Various government agencies are mandates to provide facilities such as work permits, residency permits, etc. to the foreign investors.

Objections by Guardian Council to the June Version

As mentioned earlier, the Guardian Council vetoed the June Version due to inconsistencies of this law with the Constitution and other laws. The following is the summary of the main objections presented by the Guardian Council:

- The Guardian Council objected to the ability of foreign government and organizations to invest in the Iranian economy. The Council argued that such investment would lead to foreign domination in Iran's economy based on foreign political interest.
- The Guardian Council also stated that as worded, the June Version would be annulling other restrictions on foreign investors that are in place. This was based on the fact that foreign investors were permitted to invest in all areas open to private Iranian investment and that all laws, regulations, etc. contrary to this law would be nullified. For example, the Council argued that as worded, the June Version would allow foreign investors to purchase immovable property since this version states that foreigners can invest in all areas open to the domestic investor and any contrary laws are null and void.
- Too much power was given to the Deputy minister of Finance and Economy as well as Investment Council as the main decision making body regarding foreign investment. Such decisions should have been with the Minister of Economy or in certain instances to the cabinet or Parliament.
- The Council didn't approve all blanket exemptions available to domestic investors to be also available to foreign investors.
- Fault was found with the way the Parliament had stated the exchange rate for repatriation of profits. Parliament's version attempted to provide the highest exchange rate by stating so. However, the Council objected based on the fact that in the near future there will only

be one official exchange rate.

- Under the June Version, the foreign investor was also permitted to repatriate profit in the form of exporting any goods (not just from their own joint venture). The objection was to provide clarification that those goods must be from the foreign investors own production. If other goods are sought, then the government must approve such goods.

- The fact that Iranian expatriates were permitted to be covered under this law was discriminatory towards local Iranian.

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- A ten year favorable legislation guarantee for foreign investors was discriminatory against domestic investors who did not enjoy the same protection.

- Permitting foreign governments and organizations to invest in Iran could lead to foreign domination.

The November Version of LAPFI

Following the foregoing objections by the Guardian Council, a joint committee was formed consisting of member of both the Council and members of Parliament. The joint council worked on a revised draft that would seek to present a version complying with such objections. This committee – in sessions held in late October – provided a revised draft to the Parliament. On November 4, 2001, the Parliament ratified an amended draft ("November Version"). Many of the articles remained intact and others were changed to comply with the objections of the Council.

Overview of November Version:

Foreign Investor under November Version

Based on the new version of the law a foreign investor has been defined as "any natural person or legal entity of foreign nationality." Although this definition suggests a broad based coverage there have been modifications made to the previous version.

Absent under this draft, are the inclusion of both Iranian expatriates and foreign international organizations or governments from the meaning of foreign investors.

Types of Foreign Capital Accepted under November Version

Foreign investors are permitted to utilize and import the following types of "Capital" into Iran:

- Cash

- Equipment and machinery

- Tools and spare parts, raw material, manufacturing parts, additives and auxiliary materials.

- Intellectual property in the form of patent rights, technical know-how, trade names, trademarks and specialized services.

- Conversion of dividends to the capital of the company.

- Other cases of legal currency or commodity transfer approved by Council of Ministers.

Fields Open To Foreign Investment under November Version

Two types of investment are permitted under this law. The first is foreign direct investment in the fields of "industry, agriculture, mines, construction and services" to the extent that the private Iranian sector can invest in them as well. It should be noted that the foreign investors may still be limited by other laws to invest in all such fields. For example there is a law restricting ownership of immovable property by foreign persons.

The second type of investment is related to financing schemes such as buy backs, Build Operate Transfer (BOT) and project financing. This means that foreign oil companies for most oil projects in Iran could benefit from the protection of this law. However, an important exception is made. Foreign investors in such projects can only derive their capital and dividends and capital from the project itself and the government is forbidden from granting any type of financial or government guarantee from other sources. Moreover, if the government is to utilize such financing scheme then the Parliament must also approve the transaction. This is a clear indication that there has been an attempt by the legislature to control the types of projects the government engages in.

Government Authority and Time Frame of Application under November Version

Based on this law, the Organization for Investment Economic and Technical Assistance of Iran ("OIETAI") remains as the main body for encouraging foreign investment and processing applications for licenses. However, unlike the previous version, aside from the Council of Ministers, the Minister of Economy and Finance has been required to approve many transactions relating to foreign investment licenses. This includes final approval of investment license, dividend repatriations, transfer of interest, etc. This has created an additional and unnecessary bureaucratic hurdle.

Based on the law, the government is mandated to make its decision regarding the investment license within 45 days of receipt of the application. This is perhaps a very ambitious goal since currently it takes anywhere from six months to one year for such applications to be processed and approved.

Sovereign Guarantee under November Version

For those foreign investors that have been granted an investment license under this law, the government of Iran – through the council of ministers – guarantees that the investment cannot be nationalized or appropriated unless with payment of fair compensation by the government to the foreign investor. The law has indicated that this must be consistent with legal due process and compensation based on real market value of the capital that has been appropriated.

Foreign Currency Transactions and Rates under November Version

The law allows the foreign investor to directly import its cash in the form of foreign currency into Iran and convert it into Rials. The difference in this version is that there has been a specific reference made to the unified exchange rate (which has not been officially enacted in Iran yet). Absent such an official rate based on the unified rate, then the free market rate (as determined by the central bank of Iran) will form the basis for any type of currency conversions.

Also, the foreign investor is permitted to maintain foreign currency account – without the need for conversion to Rials -- for purchases of equipment and the like abroad.

Repatriation of Dividends and Capital under November Version

Unlike the current foreign investment law – which allows repatriation of profits only through proceeds of exports earned by the project – the new foreign investment law provides various options for repatriation of profits. The law provides for the following mechanisms for repatriation of profits:

- Purchase of foreign exchange from the Iranian banking system
- Utilization of foreign currency earned from the proceeds of exports of products produced by the project
- Export of other Iranian services and goods as approved by the Council of Ministers

The repatriation issue is perhaps one of the most important changes of the foreign investment law. Until now, foreign investors had to have exports and foreign currency derived from such exports to fund the foreign currency required for repatriation of profits. This was very problematic since many projects may have been targeting the domestic market. Moreover, other laws and regulations created problems for utilizing the foreign currency earned from exports for repatriation of profits. The new law allows the foreign investor to purchase foreign currency from the various legal sources available under the Iranian banking system.

It must be seen in practice whether the government will permit the foreign investors to use all the provisions of this law for repatriation of profits or not. Much will depend on the foreign currency earnings of the country, as is the price of oil.

Dispute Resolution under November Version

Unlike the 1955 law, this version allows for different forms of dispute resolution. This law states that disputes will be referred to Iranian courts unless a Bilateral Investment Treaty ("BIT") exists between Iran and the country of the foreign investor permitting for arbitration.

Although attempting to utilize modern investment procedures – such as arbitration – this has been a very weak and ineffective attempt. First, there are not too many countries that Iran has signed a BITs with. Second, even if there is a treaty, the Constitution of Iran only allows governmental entities to enter arbitration proceedings with foreign investors following an approval from the Parliament. Therefore, there are many conditions precedent – such as Parliamentary approval and BITs – before foreign investors can utilize dispute resolution of their choice.

Comparison of June and November Versions of LAPFI

The following are the primary changes that the November Version makes to the June Version:

- The definition of "foreign investor" has changed by omitting Iranian expatriates and international organizations and institutions. Only private foreign persons will be able to enjoy the protection of this law.
- As opposed to all field available to Iranian domestic investment, direct foreign investment has been referred to in the fields of industry, agriculture, mining, construction and services. There also has been clarification that other laws limiting foreign investment will stay intact (i.e. law on limitation of ownership of immovable property by foreigners).
- Financing schemes such as buy backs, BOTs and project financing are still permitted but only if there is no need for government or bank security. The payments of dividends and return of capital can only be generated from the project itself.
- The Council of Ministers will determine the ratio of foreign ownership as well as areas permissible for foreign investment
- The Organization for Invest-

ment, Economic and Technical Assistance of Iran (OIETAI) will be the only official body to encourage foreign investment as well as to receive applications

- The Minister of Economy and Finance – as opposed to the ministry – is the person responsible party to the Parliament. Moreover, all investment licenses must be both approved and signed by minister as well following ratification by the council of ministers. Also, all transfers to other foreign investors of licenses can occur if approved by the minister. The Minister must also approve any remittance of dividends or capital abroad.

- Foreign investors will have the same support – as opposed to exemptions -- available to Iranian investors from the government.

- Regarding the exchange rate for repatriation of profits and other foreign currency transactions, the rate will be the unified rate (if so implemented by then) otherwise the free market rate as recognized by the Central Bank of Iran.

- Referral of disputes between foreign investor and government to a Bilateral Investment Treaty ("BIT") can only occur if the BIT has been ratified by the Parliament.

- If any dispute between government entities regarding the provisions of this law, it will be finally settled by the Minister of Economy as opposed to the President's representative. This was because the minister if ultimately responsible to the parliament while the president is not.

- The provision that foreign investors would be exempt from unfavorable changes of law for a period of 10 years has been deleted from this draft. The relevant language states that foreign investors will enjoy the benefits of this current law even if it is changed unless the new law provides for more privileges.

- Foreign investors are still permitted to repatriate profits according to the provisions of the June Version.

Overall Shortcomings of November Version

Iran, by its own admission, requires a vast amount of foreign investment to save its ailing economy. To do so, Iran must reduce legal uncertainty and provide for simple legislation, enforcement of contractual obligations, international arbitration (without need of approval from Parliament) and an end to unnecessary bureaucratic intervention. This law has fallen very short from such basic requirements. Rather than make the process for bringing capital into Iran simple the new law has not only maintained the old bureaucracy but also added additional hurdles. For example, there is a need for an application to OIETA, followed by a meeting and approval by a board consisting of most the ministries in Iran. In addition, the Minister of Economy and Finance must also provide for many approvals. In some projects, the permission of the parliament may also be necessary. Such a long process discourages foreign investment and provides for decisions based on political trends of authorities as opposed to the economic need of the country. This also leaves the door open for those who have vested interests to keep the status quo and not permit foreign investment – and as such competition – in such areas.

The fact that the government – through its various bodies – retains discretion in defining areas of foreign investment, percentages of foreign shareholding, what types of conflicts can go to arbitration, etc., provide for much uncertainty to potential foreign investors. This will only limit the types of investment in this country.

Also, the new law has failed to provide any specific exemptions to the foreign investor (such as limited tax holidays, exemptions from import/export duties, monopolies, etc.,) Iran should be cognizant that such exemptions would be needed and in fact standard practice in countries with modern investment law.

Developing nations that have been successful in attracting foreign investment have produced a very simple and investor friendly foreign investment law by utilizing modern legislative methods. For example, in such countries there is no need for various governmental bodies to approve the investment. Rather, the investment is automatically registered following submittal of the required application and the government has the burden to show why the investment should not be registered. Only in specific examples such as environmental and safety issues, will an application be closely scrutinized. Iran's new foreign investment law lacks simplicity of obtaining such investment licenses and subjects the foreign investor to various hurdles. It is interesting to see the main body entrusted with foreign investment issues – OIETA – has almost no powers by itself to register the foreign investment.

The foregoing issues are compounded by the fact that Iran still has not modernized other areas of laws that have a direct impact on foreign investment. The foreign investment bill by itself cannot function properly unless there are other laws supporting it. As such, there is still a strong need to amend or make new laws in areas such as the commercial code, civil code, labor laws, tax laws, anti-trust laws (does not exist yet), arbitration, enforcement, etc. Moreover, the foreign currency regime of Iran must also reflect the requirement for attraction of foreign investment. Without the proper legal foundation to support it, the new foreign investment law will collapse.

Lastly, Iran must also visit its Constitutional restrictions with an eye of amending some of them in order to provide more security to foreign investors. The current Constitution allocates most the country's resources to the monopoly of the state (See Article 44). There is also direct restriction on providing concessions to foreign companies (Article 81). Although these articles have been interpreted liberally permitting much activity by the private sector as well as foreign investors there is a need to provide for transparent and clear instructions on what the definition of the private sector as well as areas of foreign participation are. This can only be done by a Constitutional amendment.