ATIEH ASSOCIATES

Legal Newsletter

June – July 2002 Vol. 2 No. 3

Overview Of The New Foreign Investment Law

Following months of dispute between the Parliament and Guardian Council, the Expediency Council ratified the final version of a new foreign investment law in Iran coined as the Foreign Investment Promotion and Protection Act ("FIPPA") on 26 May 2002.

Under FIPPA and similar to the previous foreign investment law, commercial risks are not covered but any expropriation or nationalization will be compensated by the government. In some cases, if an act of the government disrupts the business activity, the government will be under obligation to make payments for any loan installments that are due on behalf of the project company. The law also permits more options for repatriation of profits in hard currency combined with a broader definition of foreign investment. For the first time, project financing schemes such as buy back agreements and BOT projects (only under an operator status) are specifically covered under the foreign investment law.

1. Conditions of FIPPA

Under the FIPPA, any foreign natural or legal person – including Iranian expatriates -- importing capital in Iran will enjoy the benefits and privileges of this law as long as:

- The investment leads to economic growth, promotes technology, promotes quality of products, increases employment opportunities, increases exports and entering the international markets.
- The investment does not jeopardize national security and public interests or harm the environment or interrupt national economy or disrupt products of domestic investments.
- The investment does not involve the granting of any special rights resulting into a monopoly.
- The value ratio of goods and services produced by aggregate of foreign investments does not exceed 25% in each economic sector and in each economic branch shall not exceed 35%.

FIPPA will be applicable based on the nationality of the Foreign Capital as opposed to the investor. As long as the capital comes from foreign sources, any one importing it will be eligible for FIPPA protection including Iranians residing in Iran or abroad.

2. Definition of Foreign Capital

For the purposes of the FIPPA, foreign capital is defined as:

- Sums in cash entering the country in the form of exchangeable currency though the Iranian banking system or other means approved by the Central Bank of the Islamic Republic of Iran.

- Equipment and machinery.

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

- Patent rights, technical know-how, trade names, trademarks and specialized services.

- Transferable dividends of stocks belonging to the Foreign Investor.

- Other authorized cases with the approval of the Council of Ministers.

3. Types of Foreign Investment

The FIPPA provides for two types for foreign investment which are protectable. These are:

- Direct Foreign Investment in those fields that private sector activity is authorized.

- Foreign Investment in all sectors within the schemes of "civil partnership," "buy backs," and "build, operation and transfer (BOT)" where the return of principal and profit arises solely through the activity of the same investment project and does not rely on any guarantee by the government, government companies or banks.

4. Protections Available

Once an investment is authorized and registered under FIPPA, it will enjoy full protection of the law including a sovereign guarantee in case of nationalization or taking. Article 9 of this law provides that:

Foreign Investments shall not be deprived of ownership or nationalized unless for the public good, through a legal due process, in a non discriminatory manner, and against payment of appropriate compensation based on the real value of the investment immediately before the appropriation.

As indicated from the above, the compensation must be based on the "real value" of the investment and as such there has been inclusion of objective standards in determining what the compensation should be. This is a major shift from the previous LAPFI's requirement of "fair compensation" which left the door open to arbitrary and subjective treatment.

A new protection provided in this law is the so called business disruption compensation by the government if it causes such disruption. In this regards, FIPPA provides:

In the case of investments subject to Clause B of Article 3 of this Law [i.e. civil partnerships, Buybacks and BOTs as described above], should laws or government regulations lead to prohibition or cessation of approved financial agreements, then the government shall procure and pay the resulting damages with the ceiling being the matured and due installments. Limits of the reimbursable undertakings according to this Law shall be approved by Council of Ministers.

This means if any act of the government disrupts

1st Floor, Building No. 74, Argentine Square, Tehran 15139, Iran
Tel: + 98 21 872 1112 Fax: + 98 21 872 0 077
www.atiehassociates.com info@atiehassociates.com

the investment company's activities, it will have to make the payments for loan installments while the disruption continues. It should be noted that this does not include commercial risks or changes in law that affect the profitability of the venture. Neither does this protection seem to apply in cases of direct foreign investment but rather it is applicable to project financing scenarios. An example of this protection would be where the government cuts the gas supply to a privately owned power plant as a result of which the operation ceases. During this time the government is obligated to make the payments for any loan installments of the power plant.

Finally, the FIPPA has for the first time permitted – subject to restrictions -- for resolution of conflicts other than Iranian courts. Article 19 of the FIPPA provides:

Any disputes which may arise between Foreign Investors and the government over the reciprocal undertakings in the framework of investments mentioned in the present Law, and which can not be settled through negotiations, shall be examined by domestic courts of law, unless another mode of settlement of disputes has been agreed upon within a law on bilateral investment agreement with the government of the Foreign Investor.

Based on the above, a foreign investor can seek arbitration only if there is a bilateral investment treaty between Iran and the country of the foreign investor. This is also subject to the Constitutional restriction as provided for in Article 139 where arbitration with the government and instrumentalities can only occur with the permission of the Parliament.

5. Export of Capital

The FIPPA provides legal permission for the foreign investor to export both its dividends and principal investment in hard currency. Article 13 of the FIPPA provides:

The principal and interest of Foreign Capital or any portion of the capital remaining in Iran may be transferred abroad with a three-month notice to the Board upon fulfillment of all outstanding obligations, payment of legal deductions and the approval of the Board and confirmation of Minister of Economy and Finance.

Therefore, the Foreign Investor will be entitled to transfer in hard currency both the earned dividends of the investment as well as the principal amount imported into Iran.

The executive by laws of FIPPA, once enacted, will provide comprehensive guidelines on implementation of the new foreign investment law.

By-Laws of New Foreign Investment Law to be Ratified Soon

According to Article 25 of the Foreign Investment Protection and Promotion Act (FIPPA), ratified by the Expediency Council on May 25, 2002, the Ministry of Economy and Finance is to draft the executive by-laws on FIPPA within two months from the ratification date. Once the executive by-laws of FIPPA are approved, the former Law on Attraction and Protection of Foreign Investment and its regulations will be repealed and replaced by the new act.

Last month, the Ministry of

Economic Affairs and Finance ratified a draft of FIPPA's executive by-laws and submitted it to the Board of Ministers for final approval. The Board is expected to review the by-laws and approve them within the next month.

The 37 proposed articles concern issues such as promotion, guarantee and registration of foreign investment, creation of a system of allowance, a center for investment services, regulations for inflow of capital, and for outflow of capital and related profits, and the codification of sectors and fields that an investor can invest in.

Foreign investments subject to this Law will be exempt from any regulations related to pricing, distribution, payments of commercial benefits tax, and from foreign currency controls.

Executive Directive for Local Content Law Issued

The 1997 law, "The Maximum Utilization of the Country's Technical, Engineering, Productive, Industrial, and Executive Capability to Implement Projects and to Facilitate the Export of Services Act" (ratified March 3, 1997), otherwise known as "the Local Content" or the "Maximum Use" law was passed with the intent to maximize the use of the country's technical, engineering, productive and executive capabilities.

A new directive, issued at the end of April of this year, provides more guidelines on the implementation of the Local Content Law by government bodies. This directive requires foremost that governmental works projects be assigned exclusively to Iranian companies and institutes. If after holding a tender or after proper inquiry it is discovered that no competent Iranian company or institute is available for the task, or that competent Iranian companies or institutes are insufficient in number, executive organizations are then able to assign the project to an Iranian-foreign joint venture.

The participation interest of the Iranian company or institute in the joint venture must be 51% or more of the value of the work assigned. The executive organizations are authorized to assign work only to bidders who will implement 51% or more of the value of the work using the equipment and services which are already produced and rendered in Iran, or which are capable of being provided in Iran.

In order to ensure full disclosure, the executive organizations are required to request detailed information from the bidders, such as the amount and value of the equipment that will be manufactured by Iranian manufacturers, the amount and value of the work to be executed in Iran directly by the Iranian company party to the contract, and a thorough list of what will be developed and what will eventually remain in Iran after the implementation of the contract.

The directive also describes two instances in which authorization from Economic Council is required: a) when the participation interest of the Iranian side of the joint-venture is less than 51%, and b) when the Iranian company or Iranian joint-venture is performing or executing less than 51% of the value of the contract inside Iran.

New Tender Law Under Consideration

The Parliament has provided its general approval for a new law on government tenders. The law provides for types of projects to be put out for tender by government, government entities or government companies (including NIOC, NPC etc.) provided that the value of project exceeds the legal minimum basis. Such legal minimum will be announced by Parliament on a yearly basis. Utilization of a widespread IT-based network for announcement of tenders is also a part of the draft; more details of the draft are not announced yet. This law should provide a more comprehensive overview of the tender mechanism in Iran.

After ratification of its details by the Parliament and following approval by Guardian Council, the law will come into force. Currently, government tenders are regulated by Government Transactions Regulations ratified on 1971.

Recent International Agreements and Treaties

The following agreements and treaties were recently ratified by Iran:

1) Bilateral Investment Treaty between Iran and Oman
2) Agreement on avoiding double taxation between Iran and Macedonia
3) Customs Agreement between Iran and Bulgaria
4) Bilateral Investment Treaty between Iran and Bangladesh